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TRENDS

An Analysis of Emerging Trends in the Securities Industry

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The Need for Savings and Investment Tax Incentives in the U.S.

Highlights

1. A decline in the personal savings rate in the U.S., coupled with large government deficits in the 1980s, jeopardizes the nation's standard of living and slows economic growth.

2. The meager savings rate is more disturbing given the double-digit savings and investment rates of our international competitors. This puts U.S. companies at a disadvantage in the global marketplace.

3. The U.S. lags behind its major trading partners in capital formation, attributed partly to the higher cost of capital -- a direct result of the lack of savings and investment and higher taxes on these activities. The U.S. cost of capital is almost twice that of Japan and West Germany.

4. The U.S. no longer has the largest stock market in the world. The 67% increase in the capitalization of the NYSE from 1980 to 1988 was outpaced by a 160% gain in several other markets, with the Tokyo Stock Exchange now the largest equity market.

5. Reducing the federal deficit is the most effective solution to the nation's dismal savings rate. Given the growth in government spending in the 1970s-80s, policymakers must first rein in spending before raising taxes.

6. The tax code offers a starting point for getting personal savings and investment on track. The 1986 tax act removed most targeted tax incentives for individuals and put the return from savings and investment -- capital gains, dividends, interest -- on an equal tax footing with other income sources. Given the concern about savings and investment, tax neutrality between income sources is less important than providing incentives to save and invest.

Note: This issue is based, in part, on SIA's testimony on the need to increase savings and investment to the House Ways and Means Committee on April 19, 1989.

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Role of Savings and Investment In the Economy

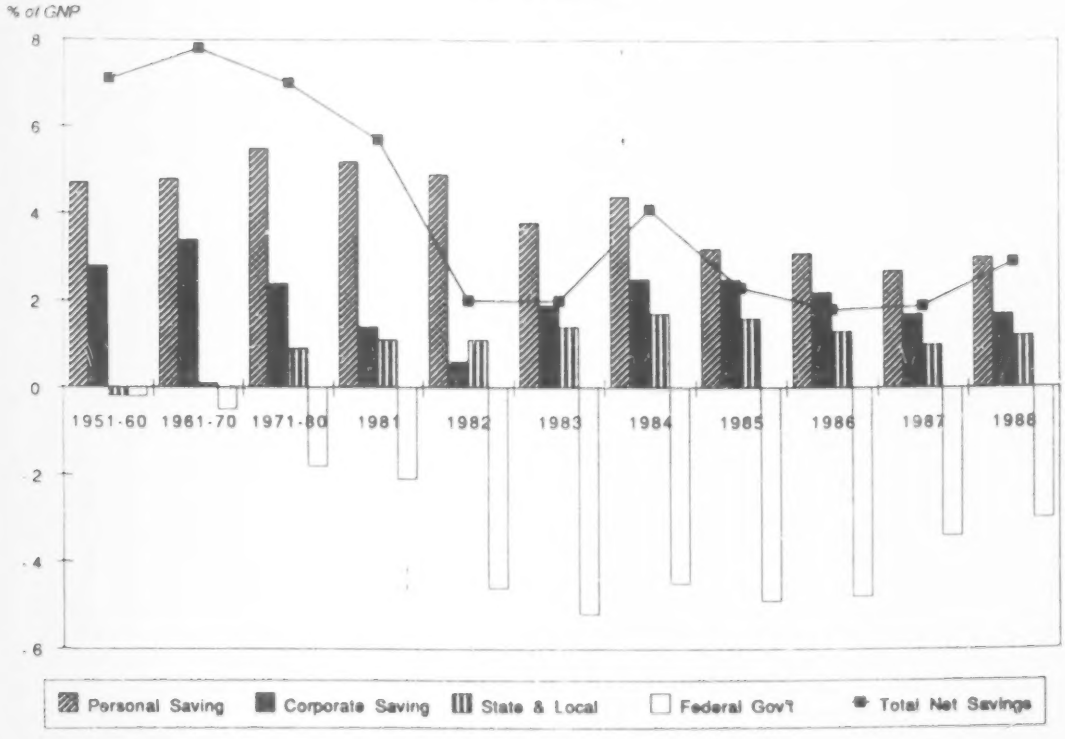
The personal savings rate in the U.S. has slid to the lowest level in about 40 years, a paltry 3.2% in 1987. While the savings rate inched up in 1988 and spurted in the first quarter of 1989 to over 5%, the 1988 gain was relatively anemic and the first-quarter jump, more an aberration than a revival of the savings ethic. However, the second quarter preliminary savings rate continued at over 5%, a hopeful sign. Overall, personal savings in the 1980s has been considerably below past experience, which is cause enough for concern. Savings fuel investment, which provides the capital necessary for economic expansion and ultimately increases the standard of living. Because our major competitors have double-digit saving rates, the meager U.S. savings rate is a formula for reducing U.S. economic competitiveness in an increasingly global marketplace.

By comparison, in the 1980-87 period, the Japanese had a personal savings rate averaging 16.8% and the West Germans, 12.3%. As a result, the ratio of gross fixed investment to GNP averaged over 20% in Japan and West Germany in this period, while it averaged about 15.5% in the U.S.

As a percent of GNP and a component of total national savings, the personal savings rate averaged around 5% in the 1951-80 period (See Chart I). Starting in 1981, personal savings began a decline which brought it to considerably lower levels through 1988. Simultaneously, as personal savings was waning, the federal deficit roared higher. As a percent of GNP, the deficit averaged 1.8% in the 1971-80 period. Over the 1981-88 period, government dissavings peaked at 5.2% of GNP in 1983 and remained more than 4% in the next three years. Hence, total net national savings dropped sharply below the over 7.0% average of earlier decades.

Chart I

U.S. NET SAVINGS



The drop in national savings is traceable to both the federal deficit and a decline in personal savings. However, wherever the blame, the combined effect poses serious threats to the economic health of the U.S. Productivity gains are made possible through investment in new technology, research, new plant and equipment. Michael Boskin, Chairman of the Council of Economic Advisers, has observed: the rate of investment itself can influence the rate of technological change in a society.

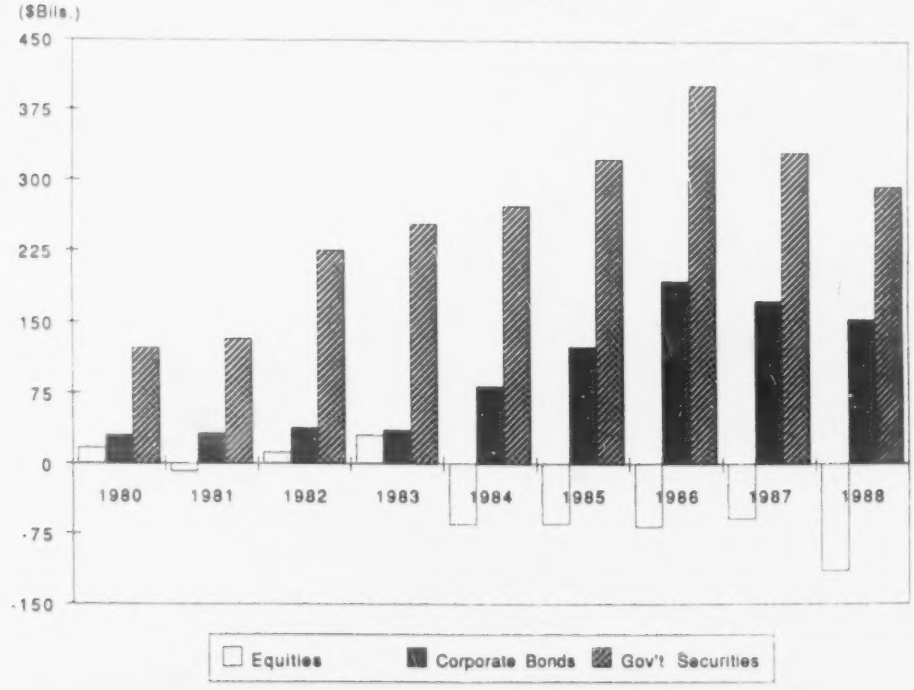
Without the national savings necessary to fund investment, the U.S. has become an importer of foreign capital. Foreign capital accounted for the difference between savings of 3% of GNP in the current decade and investment of about 4.8%. The U.S. has, in effect, borrowed the savings of other countries. While the U.S. economy benefits from such borrowing, there is a price -- the transfer of U.S. wealth to other nations.

While national savings has been sinking, record mounds of debt have been built by the government and private sectors. Targeted tax savings incentives, while they existed, have always been overshadowed by tax policies that fostered consumption. For example, in efforts to dampen consumer spending through borrowing, the 1986 tax act phased out the tax deductibility of personal interest expenses. Recently, the House Ways and Means Committee agreed to accelerate the phase-out by one year. Housing, however, is undoubtedly the largest area where government provides powerful tax incentives to consume -- the mortgage interest deduction and the deduction for property taxes (not to mention the proliferation in home equity loans). This is not the case in many other countries, where housing costs average an even larger percentage of disposable income without government subsidies.

Domestic government debt has ballooned from about $1 trillion in 1980 to about $2.7 trillion as a result of a string of annual budget deficits. Recently, Treasury requested that the public debt limit be raised to $3.1 trillion to avoid an

Chart II

Net Issuance 1980s



August default. U.S. foreign debt is around $500 billion, compared to a positive balance of about $150 billion in 1980. At the same time, the debt of U.S. non-financial companies grew dramatically, while equity capital has dwindled by almost $500 billion in just the last five years (See Chart II).

Whither the savings ethic?

Personal savings is a crucial component of the investment process, as well as the pool from which individuals fund future needs. Traditionally, individuals saved for retirement and old age. Sharp increases in social security benefits and other pension benefits, and the expansion of medicare have eased worries about economic need in old age. Moreover, most of the best academic research suggests the decline in private savings may be permanent since it reflects an enormous expansion in the wealth of older age groups.[1] The younger generation may perceive the relative financial comfort of the older generation as lessening the need for retirement savings.

Demographic trends and increasing life expectancy indicate individuals will need significant savings to enjoy their retirement. Today, at age 65, the average life expectancy is 25% more than it was in the 1930s. By 2025, the over-65 population will double. Moreover, individuals expect far more comfort in their retirement years than ever before.

Many other reasons have been cited for low personal savings -- greater company-provided health and retirement benefits, easier credit availability, and widespread life insurance coverage. So too, the rapid rise in the value of housing since the mid-1970s and the bull market of the 1980s have contributed to a general illusion of wealth. Ironically, the "Golden Goose" is being killed: The improvement in the standard of living Americans now enjoy was wrought, partly by past savings. That improvement is diminishing the propensity to save.

Little mention in discussions of the low U.S. savings rate has gone to the escalating costs of higher and post-graduate education. In a recent article, it was noted that the income gap between high school and college graduates will increase.[2] Although the percentage of high school graduates going on to college has been stable since the early 1970s, that is a larger percentage than for preceding generations.

With the rising cost of tuition and room and board, most families probably finance such outlays out of past savings or by borrowing as the student goes through school. Few families are in a position to cut back consumption on other things by a factor large enough to offset the substantially higher costs for college and post-graduate work. We believe this trend may help to explain the declining savings rate over the last 20 years or so. From 1970-86, tuition costs at private schools increased more than 10% annually on a compounded basis, compared to an increase of under 6% for all consumption items.

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1 "The Savings Slump: No Easy Solution", Wall Street Journal, 12/19/88.

2 "What's really squeezing the middle class?", Wall Street Journal, 7/26/89.

The U.S. appears to spend more on education than other nations. This is reflected, to some extent, in the higher average years of formal education in the U.S. versus other nations. For example, although dated somewhat, Table I compares the average level of education in the U.S. to that of 12 other countries. Detail for the table shows that the U.S. ranked second only to Germany in the percent of the population that completed secondary education, while ranking first, by far, in higher education.[3] We believe that trends over time in escalating costs for higher education and the need for such education may explain some of the decline in the U.S. savings rate. In part, the costs of education may be draining U.S. savings compared to other nations, where higher education costs are less or where college is completed by a smaller percentage of the population.

Whatever the reason for the loss of personal savings discipline, an increase in the savings rate is key to a higher rate of economic growth and a faster rise in the standard of living. A high rate of consumption can be financed for a time -- but not forever. When we look beyond short-term cyclical fluctuations to consider experience over the long term, the evidence is overwhelming that countries with high rates of savings and investment are the ones in which productivity, income and standards of living rise most rapidly.[4]

Table 1

Average Years of Secondary and Higher Educational Experience Of the Population Aged 25-64 in 1976

	Secondary	Higher
U.S.	4.75	1.05
12 other countries	3.47	.445
U.S. as % of other 12	137	236

International Comparison of Economic Measures

Sociological and institutional differences taint direct comparisons of savings rates among countries. For example, incentives for private housing in the U.S. reduce the need for a high level of savings for homeownership. Canada does not allow mortgage interest deductions and some other countries provide little, if any, incentives for private homeownership. Indeed, the typical U.S. housing unit is much larger than that available in other nations.

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[3] "Is the U.S. A Spendthrift Nation?", Robert E. Lipsey and Irving B. Kravis, NBER Working Paper Series, National Bureau of Economic Research

[4] "A National Savings President," Martin Feldstein, Wall Street Journal, 11/21/88.

When comparing the U.S. savings rate to that of Japan, other factors should be considered, such as the high cost of housing, limited access to credit, and the demographic trends of the Japanese population. One study found the low ratio of older to working-age individuals explained 90% of the gap between Japanese and U.S. savings. Nevertheless, "...after adjustments of every conceivable kind, what stands out in cross-sectional surveys is the low level of the U.S. savings rate and the high level of the Japanese savings rate."[5]

Direct comparisons can be misleading, but trends in savings and investment offer a reasonable comparison. When comparing the U.S. savings rate to those of other countries, the picture that emerges is disturbing. The savings rates of other countries have also been declining, albeit to a much lesser extent than that of the U.S. For example, the U.S. savings rate in 1987 was 2.5 times lower than the average U.S. savings rate in the 1970s. However, the Japanese and West German savings rates declined by a factor of only 1.2 and 1.1 times, respectively. Nevertheless, of the five major countries compared with the U.S., four had savings rates exceeding the U.S. rate by a minimum of 3 times (See Table II). Until recently, the low U.S. savings fortunately has been bolstered by foreign capital inflows, thus sustaining investment. But, there is no guarantee these inflows will continue and the need to retain such inflows restrains monetary policy to some extent.

In terms of gross fixed capital formation to GNP, the U.S. also has lagged behind its major trading partners. While a comparison of 1972 to 1987 indicates the U.S. has seemingly declined the least, the U.S. ratio is still well below that of the other countries (See Chart III). The divergence in trends in capital formation cannot be easily explained but, the cost of capital is an integral part of any explanation. Lower national savings leads to reduced investment because, by its scarcity, the cost of capital is raised. Even before the Tax Reform Act of 1986, the cost of capital in the U.S. was higher than in several of our major foreign competitors. A 1983 study by the International Trade Commission estimated the cost of capital for U.S. companies was about 16.6%, compared to about 9% for Japanese and West German companies. Higher taxes on capital and investment contribute to differences in the cost of capital between the U.S. and some foreign countries. This differential puts U.S. firms at a competitive disadvantage. Increased savings and lower capital costs would improve the ability of U.S. firms to attract equity capital and to compete successfully on the international level.

Table II

Ratio of Foreign
to U.S. Savings Rate
(Households)

Country	Foreign / U.S.
Japan	5.1X
W. Germany	3.8
France	3.7
Canada	2.9
U.K.	1.6

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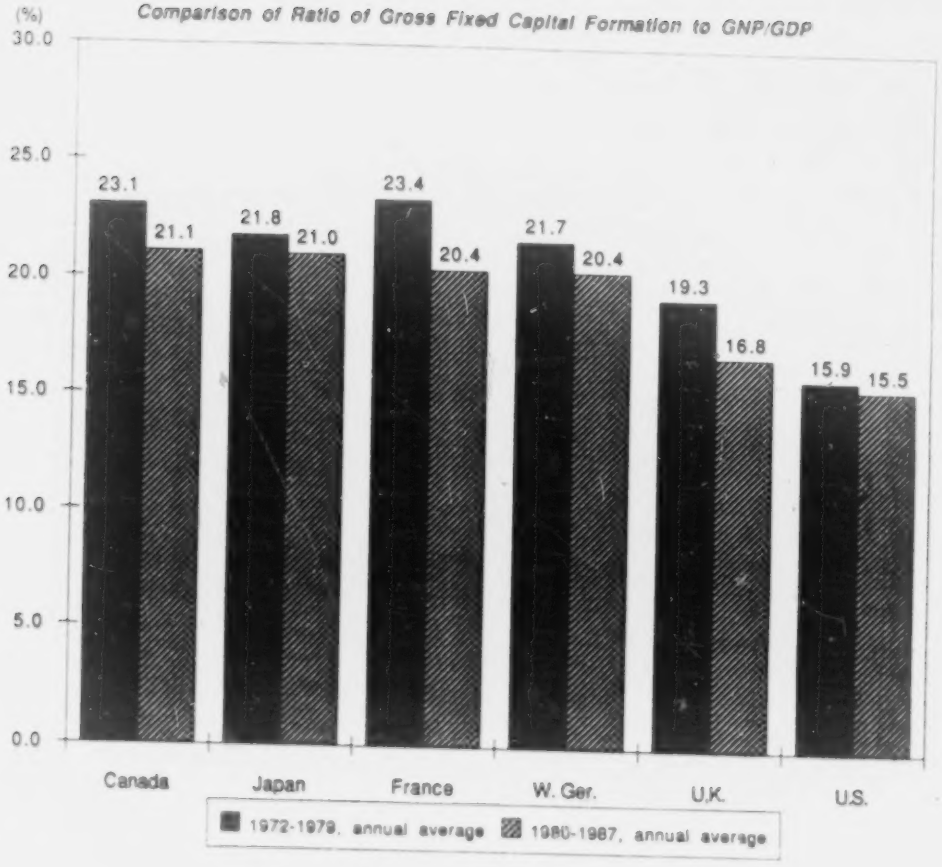
[5] "Saving Rates in Japan and the United States: The Roles of Tax Policy and Other Factors," John H. Makin, 1985.

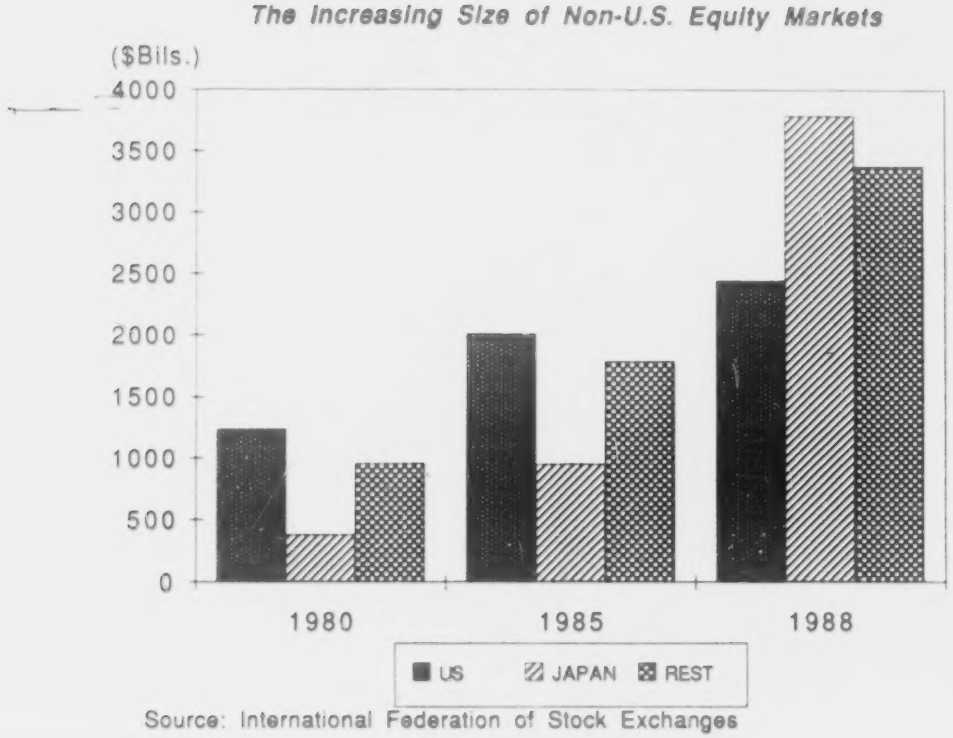
Chart III



Savings and investment also affect trade balances. Japan had a trade deficit as recently as 1981, and Germany ran a deficit in 1982. Until very recently, both countries have enjoyed increasingly hefty surpluses. The U.S., in contrast, has been in exactly the reverse position. The U.S. maintained a trade surplus until 1982. Since then, deficits have been an increasingly larger percentage of GNP. We believe that the differences in savings and investment in these countries account to some extent for the turnabout in the trade positions of these countries. West Germany and Japan are now in strong competitive positions, while the U.S. trade position is precarious.

Another indicator of the gain our foreign competitors have made in recent years can be measured by equity market capitalization. The premier position of the U.S. equity markets has been lost. The U.S. held 50% of the total market capitalization of all exchanges in 1980 and still claimed a 49% share of world stock markets at year-end 1985. However, by year-end 1988, the U.S. share of world equity markets plummeted to only 30%. Moreover, the Tokyo Stock Exchange has surpassed the New York Stock Exchange as the world's largest market. The 67% increase in the size of the U.S. market from $1.2 trillion in 1980 to about $2 trillion by year-end 1988 was outpaced by the 160% gain in several foreign markets (See Chart IV). While changes in exchange rates, particularly the appreciation of the yen vis-a-vis the dollar have played a role, the U.S. no longer has a monopoly in terms of attracting institutional and individual investors to the equity marketplace with the largest and most diversified companies.

Chart IV



Source: International Federation of Stock Exchanges

Improving U.S. Savings

The federal deficit is the major drain on the savings generated by other sectors. Reducing the deficit is the most potent solution for our national savings problem. Policymakers wrestle annually with this goal and the hard choices -- spending restraint or tax increases -- that deficit reduction entails. However, looking at the increase of government receipts and outlays relative to GNP growth provides interesting insights. From 1970, government tax receipts have more than kept pace with nominal GNP growth, with the fastest growing component social security taxes due to increases in rates and taxable bases. But, government spending has raced along even faster, outpacing both GNP and revenue growth. Past trends strongly suggest policymakers seriously look to spending restraint before considering tax increases.

Beyond deficit reduction, improving personal savings can help arrest the slide in the national savings rate. Foreign countries provide a more favorable tax treatment of investment income than the U.S., and this has helped to foster higher levels of savings and investment. It is ironic that while the U.S. can claim among the lowest rates on wage and salary income, it can also claim among the highest rates on investment income. Across-the-board, the U.S. falls behind its major competitors in the tax treatment of the return from savings -- dividends, interest,

and capital gains. In almost all other countries, targeted tax incentives are used to stimulate savings and investment.

Hence, the tax code offers a starting point for getting savings and investment back on track. In an ideal system for encouraging savings, income saved would be tax exempt and one-step removed from the ideal, the return on savings would be tax exempt. Barring the ideal, improving the after-tax return on savings through targeted tax incentives is one way to influence the savings decisions of individuals and corporate investors.

The trend in the 1980s, however, has been to eliminate targeted savings and investment tax incentives -- IRAs for most individuals, the dividend exclusion and the capital gains exclusion. The Tax Reform Act of 1986 eliminated all targeted incentives for individual equity investment. All savings and investment income is on equal tax footing with other income sources. Indeed, it is becoming clear the returns on equity investment are severely penalized by the double taxation of dividends.

The decline in personal savings should not be taken as evidence that IRAs and the capital gains exclusion, when in existence, did not have an impact on savings decisions. Many other factors may have lowered the savings rate, obscuring the positive effect of savings tax incentives. We suspect that without these incentives, the savings rate would have been lower.

The tax treatment of investment income and the IRA experience merit review and reconsideration. More specifically, policymakers should consider: 1. a permanent and meaningful reduction in the capital gains tax, 2. a method for alleviating the double tax on dividend income, and 3. a special savings allowance that encourages all individuals to save via various savings and investment instruments.

The "preferential" treatment of capital gains, which had existed for 65 years, was eliminated in 1986. The capital gains exclusion existed to acknowledge that many gains reflect nominal, not real gains; that capital loss offsets are limited to $3,000 against ordinary income; and that individuals need incentives to encourage risk taking. With the elimination of the capital gains exclusion, we have seen a continuation in the shrinkage of equity issues in the marketplace and the literal disappearance of initial public offerings (IPOs) despite a 20% increase in stock prices since the beginning of the year.

Many Ways and Means Committee members now recognize the adverse impact of eliminating any tax preference for capital gains. Policymakers are in the midst of a political struggle based on the mistaken notion that only the rich benefit from lower capital gains treatment. Many individuals realize capital gains -- homeowners, those owning their own businesses, taxi medallion owners, etc. Capital gains treatement is not a political issue, it is an economic one.

The double taxation of dividends is widely perceived as inappropriate tax policy. There has been a major restructuring of corporations in the United States, so that corporate capital structures are increasingly resembling that of other nations. The restructuring recognizes the higher cost of equity capital, given no attempt to alleviate the double taxation of dividend income and the elimination of the preferential treatment of capital gains. Most foreign competitors have some form of integration between the individual and corporate tax structures that reduces the double tax impact on dividend income. Although policymakers have been suggesting various limits on interest deductibility, the real focus should be on limiting the tax burden on dividends, thus making equity capital feasible once again and companies less vulnerable to any future business slowdown or recession.

A broad scale tax incentive like the IRA account was highly efficient in the mid-1980s. Unfortunately, a misconception about these programs was that savings was diverted from other savings programs. Recently, there has been growing evidence that IRA programs did indeed increase incentives to save and that individuals strongly preferred to save if it meant being able to reduce their taxes substantially.

Capital Gains Treatment

The 1986 tax act contained the largest increase in capital gains taxes in history; a 65% increase for investors in the top tax bracket and an even greater increase for some middle income investors. The elimination of the exclusion added a heavy weight to the bias against long-term equity investment.

The 1978 and 1981 capital gains tax cuts are a documented success story. Individuals reacted by supplying increased amounts of capital for equity investment, particularly for small companies which create jobs and new technology. Importantly, tax revenues were raised, not lost, for Treasury. But, the significant economic consequences of lower capital gains taxes are worthwhile even if revenues are not raised. (A summary of these consequences are contained in SIA's Statement to the Ways and Means Committee, April 13, 1989.)

Our foreign competitors have recognized the benefits of encouraging investment. Three major foreign countries -- Belgium, Italy and the Netherlands -- do not tax capital gain, and Germany exempts long-term gain (See Table III). Compared with the six countries taxing long-term gains, the U.S. treatment of capital gains is among the harshest. Canada, France and Sweden tax long-term capital gains at rates ranging from 16% to under 20%. While Australia and the U.K. have higher statutory long-term capital gains tax rates than the U.S., substantial exemptions and indexing of the cost basis result in more favorable capital gains tax treatment than in the U.S. Effective in April, Japanese investors have a choice of a 1% tax on gross proceeds or a 20% net capital gains tax. Previously, capital gains were exempt in Japan.

Dividend Income

In recent months, much attention has focused on the leveraged buyout phenomena and the subsequent build-up of corporate debt. Although various measures of debt are used, corporate debt as a percent of current GNP is about 37% compared with 30%-35% during the 1967-85 period. Meanwhile, in 1984-88, about $500 billion of equity was removed from the market and estimates place 1989 equity retirement as high as $166 billion.[5] Policymakers, for the most part, look to "penalize" LBO activity rather than encouraging equity investment. The anti-savings slant, or debt bias, in the tax code is most apparent in the disparate treatment of corporate debt and equity. There are legitimate financing roles to be played by both debt and equity, but there is no logical reason for the tax code to favor one over the other.

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[5] "Rapid Stock Supply Shrinkage Continues", Wall Street Journal, 7 14 89.

Table III

Summary of Individual Taxation of Capital Gains
on Portfolio Stock Investment

Countries	Maximum Short-Term Cap. Gain Tax Rate	Maximum Long-Term Cap. Gain Tax Rate	Period to Determine Short- Or Long-Term Gain	Maximum Annual Net Worth Tax Rate
United States	33%	33%	One Year	None
Australia(A)	50.25%	50.25%	One Year	None
Belgium	Exempt	Exempt	None	None
Canada(B)	19.33%	19.33%	None	None
France(C)	16%	16%	None	1.1%
Germany(D)	56%	Exempt	Six Months	.5%
Italy	Exempt	Exempt	None	None
Japan(E)	20%	20%	None	None
Netherlands	Exempt	Exempt	None	.8%
Sweden(F)	42%	16.8%	Two Years	3%
United Kingdom(G)	40%	40%	None	None
Hong Kong	Exempt	Exempt	None	None
Indonesia(I)	35%	35%	One Year	None
Malaysia	Exempt	Exempt	None	None
Singapore	Exempt	Exempt	None	None
South Korea	Exempt	Exempt	None	None
Taiwan(J)	Exempt	Exempt	One Year	None

Note: This is a summary of the preliminary results of a study by SIA/Spicer Oppenheim to be completed in August. Details will be provided on special situations affecting the taxation of capital gains in the final study. Conversion of exchange rates as of 4/7/89. State, local and provincial taxes not included.

(A) Long-term capital gains from assets acquired prior to 9/20/85 is tax exempt and cost basis of other assets held more than 1 year is indexed for inflation.
(B) Lifetime cumulative capital gain exemption of $83,857 (Canadian $100,000); $419,287 (Canadian $500,000) for gain on sale of shares in small business.
(C) Exemption for capital gains on sale proceeds of up to $45,518 (FF 288,400).
(D) First $533 (DM 1,000) of short-term gain is exempt annually.
(E) Effective 4/1/89, capital gains tax on sale of stocks or securities. Previously, gain was exempt.
(F) A 60% exclusion for long-term gain produces lower long-term rate.
(G) First $8,480 (5,000 pounds) of gain is exempt annually.
(I) For securities held more than 1 year, gain is taxed at an average effective rate which varies depending on several factors, but is generally lower than 35%.
(J) During 1989, the following are tax exempt: (1) all gain from the sale of stock acquired before 1989 (2) up to $366,300 (NT $10,000,000) of gain on stock acquired after 1988, and (3) 50% of the gain on unlisted securities held for more than one year. If these exemptions do not apply, the individual is subject to national income tax at a maximum rate of up to 50%.

The full deductibility of corporate interest payments and the double tax on corporate dividend payments have been a long-standing feature of the tax code. However, many point to the 1986 tax act as stimulating the trend toward debt financing that began in the mid-1980s. Under the old law, corporations could enhance the returns of taxable investors by retaining and converting earnings into capital gains, which were taxed at a lower individual rate than dividends or interest. The 1986 tax act eliminated this distinction. In addition, while the incentive to retain

earnings from the viewpoint of the shareholder was eliminated, the 1986 act also made it more advantageous for a corporation to disburse income (capital gains or other income sources) because individual rates were now lower than corporate tax rates.

Table IV

Summary of Individual Taxation of Dividend Income

Countries	Corporate/ Shareholder Integration	Maximum Marginal Tax Rates	Special Allowances Or Exemptions Other Than Integration
United States	No	33%	None
Australia	Yes	18.4%	None
Belgium	No	25%	None
Canada	Yes	19.6%	None
France	Yes	35.2%	Annual Exemption (A)
Germany	Yes	31.3%	Annual Exemption (B)
Italy	Yes	21.9%	Special Allowance (C)
Japan	Yes	45%	Annual Tax Credit (D)
Netherlands	No	72%	Annual Exemption (E)
Sweden	No	42%	Annual Deduction (F)
United Kingdom	Yes	20%	Special Allowance (G)
Hong Kong	NA	Exempt	NA
Indonesia	No	35%	None
Malaysia	Yes	15.4%	None
Singapore	Yes	0%	None
South Korea	Yes	25%	Special Allowances (H)
Taiwan	No	50%	Annual Exemption (I)

Note: This is a summary of the preliminary results of a study by SIA/Spicer Oppenheim to be completed in August. For countries that have integration, the maximum effective rate is shown. Details will be provided on methods of integration and special situations affecting the taxation of dividend income in the final study. Conversion of exchange rates as of 4/10/89. State, local and provincial taxes not included. NA - Not applicable.

(A) Annual dividend (or interest) exemption of $2,526/$1,263 (FF 16,000/FF 8,000) for married single taxpayers.
(B) Annual dividend (or interest) exemption of $321/$160 (DM 600/DM 300) for married/single taxpayers.
(C) Special savings stock similar to preferred but without liquidation preferences taxed at 15% rate at the source.
(D) Annual tax credit of 10% of dividend income up to $75,700 (Yen 10 million) and 5% for the excess over that amount.
(E) Annual exemption of $947/$473 (DFL 2000/DFL 1,000) for married/single taxpayers. Special $473 (DFL 1,000) exemption for dividends for recognized venture capital company.
(F) Annual deduction of $257 (SEK 1,600) per person.
(G) Tax exemption for dividends on personal equity plans.
(H) A 10% maximum tax applies to dividends on (1) stock exchange listed shares, (2) certain agricultural, fishing and livestock companies and (3) employee shareholders of non-listed stock.
(I) Annual exemption of $13,338 (NTD 360,000) for listed companies dividends.

Most foreign countries have some form of integration of corporate and individual taxes to mitigate the double tax on the current return on equity investment. Of ten major industrialized countries, seven have a form of integration (See Table IV). Moreover, of these seven countries, five -- France, West Germany, Italy, Japan and the U.K. -- also have special allowances and exemptions to encourage equity investment.

Interest Income

Similarly, four of ten major foreign countries generally apply tax rates lower than in the U.S. on interest income (See Table V). Of note, Japan has the lowest rate, 15%, on the investments reviewed. In addition, while some countries have rates higher than the U.S. and some have exempted instruments equivalent to municipal obligations, other savings incentives are also provided. For example, interest on 5-year savings accounts of a maximum of $11,759 is tax exempt in Sweden.

Table V

Summary of Individual Taxation of Interest Income

Countries	National Government Bonds	Corp. Bonds	Savings Accounts	Other Interest	Special Allowances Or Exemptions
United States	33%	33%	33%	33%	Exemption (A)
Australia	50.25%	50.25%	50.25%	50.25%	None
Belgium	25%	25%	25%	25%	None
Canada	29%	29%	29%	29%	None
France	56.8%	56.8%	56.8%	56.8%	Exemption (B)
Germany	56%	56%	56%	56%	Exemption (C)
Italy	12.5%	12.5%	30%	50%	Exemption (D)
Japan	15%	15%	15%	15%	Exemption (E)
Netherlands	72%	72%	72%	72%	Exemption (F)
Sweden	42%	42%	42%	42%	Exemption (G)
United Kingdom	40%	40%	20%	40%	Exemption (H)
Hong Kong	Exempt	Exempt	Exempt	Exempt	None
Indonesia	35%	35%	15%	35%	None
Malaysia	Exempt	45%	5%	40%	Exemption (I)
Singapore	Exempt	Exempt	Exempt	Exempt	None
South Korea	10%	10%	10%	25%	None
Taiwan	50%	50%	50%	50%	Deduction (J)

Note: This is a summary of the preliminary results of a study by SIA/Spicer Oppenheim to be completed in August. Details will be provided on special situations affecting the taxation of interest income in the final study. Conversion of exchange rates as of 4/10/89. State, local and provincial taxes not included.

(A) Interest from state and local obligations is tax exempt.
(B) Interest on certain savings accounts is tax exempt. Elected withholding at the source results in 27%, and 47% rate on savings account. Annual rate on bonds interest (or dividend) exemption.
(C) Interest on certain long-term government bonds exempt.
(D) Certain bonds are tax exempt or taxed at lower rates.
(E) Interest on certain employee savings accounts exempt.
(F) Annual exemption of $944/$472 (DFL 2,000/DFL 1,000) for married/single taxpayers.
(G) Certain savings accounts for a 5-year term are exempt. The maximum account is $11,759 (SEK 75,000).
(H) Interest on National Savings Certificates is exempt.
(I) Interest on savings accounts of up to $1,832 (M $5,000) is exempt. Interest on fixed deposits held for at least 12 months with the National Bank is tax exempt.
(J) Special deduction of up to $13,153 (NTD 360,000) can be offset against interest (or dividends) from certain types of savings and investment.

IRAs/401(k) Plans

Similar to preferential treatment of capital gains, Individual Retirement Accounts(IRAs) are an example of a targeted tax incentive of the 1980s that was tried, worked and then weakened. With the liberalization of IRA requirements in 1982, these accounts were claimed on 12 million tax returns, bringing about $28.3

billion in savings. By 1986, over 15 million returns showed IRA contributions of over $37 billion. The 1986 tax act curtailed the tax deductibility of IRA investment for most individuals. In 1987, with the limited availability of the IRA tax deduction, only 7.4 million returns claimed IRAs and the amount of funds saved in these accounts plunged 62% to only $14.1 billion (See Table VI). The tax deductibility of IRA contributions proved a powerful incentive for generating significant savings -- a fact that is now being confirmed by considerable research.

While the statistics show that individuals did indeed respond to the IRA tax incentive, much controversy has surrounded the origin of IRA funds -- new savings or the shift of other assets. Included in the IRA literature is a series of studies by Steven F. Venti and David A. Wise for the National Bureau of Economic Research. Three of their main conclusions are: 1. IRAs had a substantial positive net effect on personal savings; 2. Two-thirds of the families contributing to IRAs had annual incomes of less than $50,000; and 3. IRAs did not merely substitute for other forms of retirement savings.

Table VI

Individual Retirement Arrangements
Adjustments to Income
($ Billions)

Year	Number of Returns	Amount
1980	2,564,421	$3.4
1981	3,415,053	4.8
1982	12,010,038	28.3
1983	13,613,167	32.1
1984	15,232,856	35.4
1985	16,205,846	38.2
1986	15,535,531	37.8
1987P	7,351,364	14.1

Source: Statistics of Income Bulletins

Hence, actual data and a growing pool of academic research combine to present a strong case for IRAs as a savings incentive. In addition, an often unrecognized benefit of IRA-type incentives is psychological. Through the very advertising that firms engage in to attract IRA accounts, individuals may focus more on the need to save.[7] For tax year 1984, about one-half of IRA contributions were made in 1985. This "last minute" response suggests that the stepped-up IRA advertising also stepped-up individuals' awareness of this savings incentive and sensitivity to tax policy.

Section 401(k) plans have had explosive growth during the past decade. The combined assets of these plans exceeded $70 billion by 1986. In that year alone, employees contributed $6.4 billion and employers added $2.4 billion, according to the Employee Benefit Research Institute. Most of these plans offer a combined appeal for saving: a tax incentive from the government, a "matching" payment from the employer, and the ease and convenience of an automatic payroll deduction.

---

[7] "The Budget Deficit Problem: 1989" by Lawrence H. Summers, Tax Notes, 3/6 89.

It is too soon to quantify the damping effect the 1986 restrictions on these plans may have had. Some plans have been cancelled, and some funds previously contributed have undoubtedly been diverted from savings. No reliable data measuring these effects has yet been developed.

Special Allowances and Exemptions

Special allowances and exemptions are widely used by many foreign nations to spur individual savings and investment. The following is a small sampling of the special provisions used by other countries in the treatment of savings and investment income.

Capital Gains: Canada has a lifetime exemption of $83,857 and a larger exemption for proceeds from sale of shares of small business. France excludes capital gains on sale proceeds of up to $45,518.

Dividend Income: Most major countries use an integrated system as well as exemptions and deductions for dividend income. The Netherlands has an annual exemption of $947 $473, while the U.K. exempts dividends (and capital gains) from "personal equity plans".

Interest Income: Several countries offer tax exemption for the interest return on certain investments and types of savings deposits held for a specific period of time; i.e., five years in Sweden. In the U.K., the interest return on a National Savings Account is tax free.

Summary

Tax incentives can and have stimulated individual savings and investment. The U.S. cannot afford to wait to encourage savings. An aging population and increasing competitive challenges do not allow room for error in calculating future savings and investment needs. With the tax code now void of any targeted savings incentives, policymakers have an opportunity to implement meaningful measures to improve U.S. savings and investment.

In particular, with concern over the debt build-up by corporations, government and consumers, initiatives to foster equity investment would make a start at alleviating the tax code's debt bias. A reduced capital gains tax and relief from the double tax on equity are relevant options. So too, many individuals responded to the IRA tax incentive for savings.

Policymakers have many hard decisions to make, particularly when faced with trade-offs between additional spending and tax policies. However, policymakers also need to recognize that a dangerous trend has started in the U.S. -- a meager savings rate that has forced the U.S. to rely on the savings of other countries to finance investment. There is nothing wrong with foreign investment per se, except that sooner or later it involves a transfer of resources from the U.S to other nations to pay for borrowed funds. It also puts severe pressure on U.S. monetary policy to keep the dollar strong and interest rates relatively favorable to continue to attract and retain foreign funds in the U.S.

Substantial changes are taking place in the U.S. through corporate restructurings and other developments. The tax code plays a major role in these changes. Corporations and individuals respond to tax incentives as well as tax penalties -- this has been demonstrated many times in the past. If Congress wants to reward risk-taking and equity investment, the tax burdens have to be lifted. Increased taxes on interest will only serve to curb an important source of capital in this country relative to other nations and put U.S. investment at a competitive disadvantage.

Government spending has increased faster than GNP -- a documented trend. Many individuals favor additional government spending because it offers them

greater benefits and expectations. However, government spending has to be financed eventually -- witness the recent furor over catastrophic medical insurance for the elderly. Additional spending cannot be financed without greater deficits or higher taxes, neither of which is desirable given the recent trends in these areas. When public programs become unweildy, there is much temptation for fraud and waste -- as with the recent HUD debacle.

Other nations are increasingly learning that the private sector does a much better job than the public sector in allocating resources and providing for an expanded economy. The U.S. should continue to heed its own example and rely on the private sector. Nevertheless, if the U.S. savings rate is to be boosted, targeted tax programs to encourage savings are necessary. Both the capital gains exclusion and IRA programs are two recent examples of very successful incentives that were eliminated. We believe it is time to take some small steps forward and re-enact such measures rather than argue that the 1986 tax act negates such programs.

Carolyn Hildebrandt
Assistant Vice President &
Director of Macroeconomic
Studies

Jeffrey M. Schaefer
Senior Vice President &
Director of Research

VOLUME

	MAY 1989	YTD 1989	MAY 1988	YTD 1988	% CHG YTD 1989-1988
AVERAGE DAILY SHARE VOLUME ON					
NYSE (MILS.)*	170.4	165.8	153.9	170.5	-2.8%
AMEX (MILS.)*	11.5	11.7	8.9	10.3	13.5%
NASDAQ (MILS.)*	140.0	133.4	117.5	125.7	6.1%
REGIONAL EXCHANGE (MILS.)*	27.3	26.5	19.6	23.6	12.2%
DOLLAR VALUE OF SHARES TRADED ON					
NYSE (MILS.)	$136,380	$611,358	$101,526	$584,339	4.6%
AMEX (MILS.)	3,605	14,692	2,453	13,556	8.4%
ODD-LOT SHARES PURCHASED ON NYSE (THOUS.)	11,489	46,966	6,504	36,830	27.5%
ODD-LOT SHARES SOLD (INCLUDING SHORT SALES) ON NYSE (THOUS.)	18,219	84,821	13,597	73,206	15.9%
NYSE BLOCK VOLUME AS A PERCENT OF TOTAL SHARES TRADED	52.2%	52.5%	57.3%	53.8%	----
CONTRACTS TRADED (THOUS.)					
CBOE OPTIONS	11,499	53,341	8,116	44,528	19.8%
AMEX OPTIONS	3,564	16,874	2,789	15,345	10.0%
COMMODITY	24,575	113,787	19,708	96,072	18.4%

*MONTHLY AVERAGE
N/A - DATA NOT AVAILABLE

YIELDS

(MONTHLY AVERAGES)

	MAY 1989	MAY 1988	BASIS POINT CHG 1989-1988
BOND BUYER INDEX (20 BOND)	7.25%	7.90%	(65)
CORPORATE BOND YIELDS (MOODY'S)			
Aaa CORPORATE	9.37	9.90	(33)
Baa CORPORATE	10.46	11.04	(58)
RATIO Aaa CORPS. TO Baa CORPS.	0.91	0.90	2

PRICES

(END OF MONTH)

	MAY 1989	MAY 1988	% CHG MAY 1989-1988
DOW JONES INDUSTRIALS	2480.15	2031.12	22.11%
STANDARD & POOR'S 500	320.52	262.16	22.26%
NYSE COMPOSITE	178.85	148.04	20.81%
AMEX MARKET VALUE INDEX	356.66	294.19	21.23%
VALUE LINE COMPOSITE	263.21	226.42	16.25%
NASDAQ COMPOSITE	446.17	370.34	20.48%

UNDERWRITING

	MAY 1989	MAY 1988	% CHANGE 1989-1988
CORPORATE FINANCING (Gross New Issues - $ Mils)			
TOTAL	$22,971.6	$23,774.6	-3.4%
Common Stock	$1,763.7	$2,844.8	-38.0%
# of Common Stock Issues	46	36	27.8%
Preferred Stock	$587.9	$474.0	24.0%
# of Preferred Stock Issues	9	8	12.5%
Corporate Debt	$20,620.0	$20,455.7	0.8%
# of Corporate Debt Issues	108	135	-20.0%
MUNICIPAL FINANCING (Gross New Issues - $ Mils)			
Negotiated	$5,217.0	$6,243.0	-16.4%
# of Issues	324	403	-19.6%
Competitive	$2,210.0	$2,272.0	-2.7%
# of Issues	304	325	-6.5%

Source: Securities Data Co.

RECENT INTERESTING READING AND STATISTICAL MATERIAL

Item	Description	Source
Report on Production And Earnings of RRs In 1988	Retail production, payout percentages and earnings... were Down, Down and Down. Overall, the picture was brighter for institutional RRs. Included in this report is detailed information on; gross production levels of retail and institutional RRs; payout percentages; W-2 earnings levels and trends; and branch manager earnings. Data are listed for the industry as a whole and are also presented by firm-size categories.	Securities Industry Association Contact: Pamela I. Faber
1989 Mutual Fund Fact Book	An extensive guide on trends and statistics in the mutual fund industry during 1988. The Fact Book is divided into two main sections - text and data. The "text" section of the book covers basics in the history and development of the industry as well as trends in 1988. The data section involves information on assets, sales and redemptions.	Investment Company Institute 1600 M. Street, N.W., Suite 600 Washington, DC 20036
Save America: A Primer on U.S. Savings and its Effect on Economic Health	This study analyzes the available theory and data on savings. Among the findings were: a 2.5 percentage point increase in the personal savings rate annually could add roughly 10 percentage points to GNP in ten years, IRAs successfully generated new savings, and reducing the tax penalty on savings will result in significant increases to the amount saved. The findings of this study support tax incentives for savers.	Institute for Research on the Economics of Taxation (Sponsored by: Merrill Lynch Capital Markets)
Tax Policy for the 1990s: Challenges and Opportunities	This booklet summarizes the proceedings of a symposium sponsored by Coopers and Lybrand and New York University to explore crucial tax policy issues facing the nation in the coming decade. Participants discussed the current economic environment, fiscal policy solutions to the budget deficit, and tax policy alternatives.	Coopers & Lybrand 1251 Avenue of the Americas New York, NY 10020

Item	Description	Source
Report on New York Tax Provisions Relating To Corporate Mergers And Acquisitions	This report comments on the legislation recently enacted in New York relating to corporate acquisitions, mergers and considerations. The report concludes that the rule suffers from major defects and recommends that the rules be repealed.	New York State Bar Association (Tax Section)
Tax-Credit and Subtraction Methods of Calculating a Value-Added Tax	This report discusses the advantages and disadvantages methods used for calculating a value-added tax whether or not a value-added tax achieves the policy goals established for it could depend, in certain cases, on the method chosen to calculate the tax. Policy considerations, such as offsetting regressivity or keeping the tax from harming exports, may call for exemptions, multiple rates, or eliminating the tax for certain sales. This analysis addresses such issues.	United States General Accounting Office Washington, DC 20548
Deposit Insurance: Lessons From the Record	The deterioration of the federal deposit insurance funds, particularly the FSLIC, has become a common theme in the press and a major concern of financial regulators. This article considers possibilities for deposit insurance reform in the light of historical success and failures of bank liability insurance in the U.S.	Economic Perspectives Federal Reserve Bank of Chicago (May/June 1989)
How Capital Costs Cripple America	The stunted national savings rate raises capital costs and discourages investment effectively prohibiting some investments. This leads to overseas rivals of U.S. manufacturers having a solid advantage. This article explores three key changes in the tax laws which would help to close the gap.	Future Magazine (August 14, 1989)

A8825-1

SIA
SECURITIES INDUSTRY ASSOCIATION

TRENDS

An Analysis of Emerging Trends in the Securities Industry

Produced by the SIA Research Department

Vol. XV, No. 6 October 20, 1989

SECURITIES INDUSTRY FIRST HALF 1989 ANALYSIS

Highlights

1. Securities industry 2Q profits shot up five-fold over 1Q. NYSE member broker-dealers posted $1 billion in pre-tax earnings in 2Q, their best showing since 1Q88. However, over half of these profits were posted by the 10 Large Investment Banks (LIBs).

2. Risk-based revenues in the securities industry -- principal transactions, investment banking, M&A -- now account for 64% of all revenue vs 42% in 1980.

3. The handful of LIBs have used their capital and leverage to follow a risk-based strategy which has given them a market share this year of 50% of all industry assets, one-third of all industry revenues and capital while employing only 14% of the workforce.

4. Direct M&A fees are estimated to be $4.5 billion for full-year 1989, matching last year's total. In 1988, we estimate that the LIBs captured 56% of these fees, National Full Line firms (NFLs) an additional 27%, banks and boutiques 7%, each, with 4% distributed among other NYSE firms.

5. Consolidation continues in the investment banking areas - LIBs handled 40% of 1H89's private placement volume; NFLs managed 28%, money center banks captured a record 30%, with only 1% distributed among other firms. Meanwhile, a record 90% of 1989's corporate bond underwritings were done without syndication.

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INDUSTRY PROFITABILITY

2Q Provides Much Needed Shot In The Arm - But Is It Enough?

The long, post-crash slide of brokerage earnings finally curved up in the second quarter with a five-fold increase in profits. However, 2Q closed on the industry's best month of the year. Since 3Q had no month duplicating June's performance and closed on a very weak September (not to mention 4Q's start with a volatile, uncertain October), the uplift may only be temporary and 3Q profits are expected to be only half those generated in 2Q.

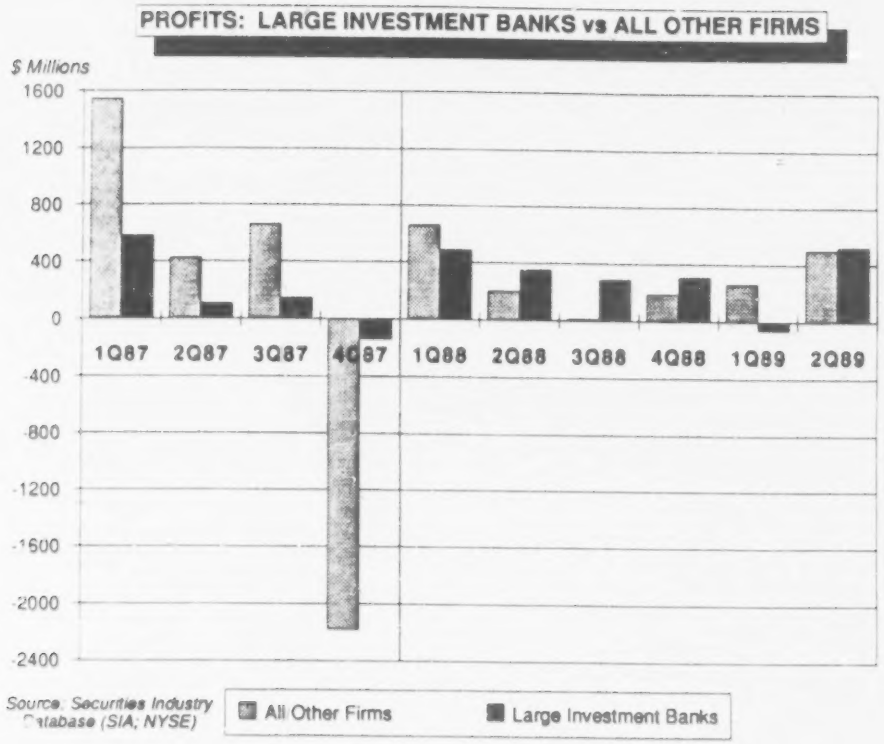
Securities industry[1/] pre-tax profits in 2Q soared to $1 billion - five times 1Q's anemic $200 million level, the post-crash low. By the way, this also equaled the combined profits for the most recent three quarters and virtually tied 1Q88 for the best post-crash quarter. The surge came from a vastly improving revenue picture spawned by increased transaction volume and particularly a falling interest rate environment.

The increase was felt across the spectrum of securities firms but particularly at the Large Investment Banks (LIBs). As **Exhibit 1** shows, the LIBs suffered the least during the crash and accounted for 58% of industry profits last year even though they make up less than 3% of all NYSE member firms.

Hurt by rising rates, with corresponding bond trading losses combined with disappointing investment banking results, the LIBs penned their first red ink since the crash during 1Q89. However, when interest rates headed downward in 2Q, they recovered and again posted profits higher than the rest of the industry combined -- a trend which greatly accelerated after the crash and has become, with time, part of the new structural fabric of the securities industry.

1/ For purposes of Trends, total "securities industry" figures are those of the domestic broker-dealer units of NYSE member firms doing a public business. While small in number (under 400), during the past few years these firms have accounted for 75-80% of total revenues of all (approx. 9,000) broker-dealers registered with the SEC. Also, these figures do not include non-domestic, non-broker-dealer business conducted within securities firms' umbrella holding companies, a substantial amount for the largest firms (LIBs and NFLs) but insignificant for the balance of the industry.

EXHIBIT 1



Industry-wide, although the totals are dominated by the LIBs and National Full Line firms (NFLs), commissions climbed 11% in the second quarter to a post-crash high of $2.7 billion. A flattening of the yield curve, which had depressed trading results for over a year while inverted, enlivened both bond trading and profits. Trading profits soared 31% to $3.7 billion in 2Q - the highest level in over two years. Underwriting revenues also shot up 23% in 2Q, but were still mediocre compared to most other quarters, both pre- and post-crash.

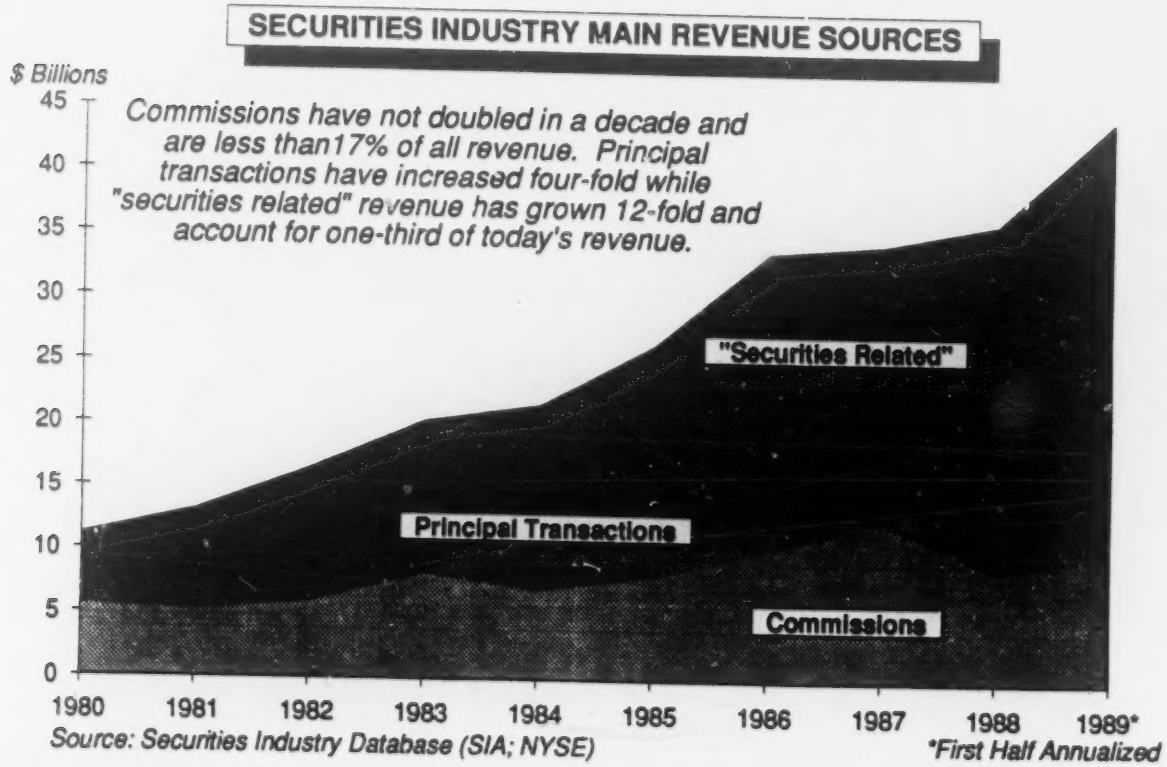
"Other revenue related to the securities business," an anachronistic hodgepodge of investment banking revenues (due to an archaic regulatory reporting schedule), continued its non-stop ascent to record levels. This line, mainly interest income (both gross and net) and M&A-related and private placement fees, climbed 12% to $5.4 billion in 2Q and now accounts for a full one-third of total industry revenues.2/

2/ It is indeed "challenging" to analyze an industry where the most important revenue line is identified as "other revenue related to the securities business" while commissions, which account for less than 17% of revenues, has four separate component breakdowns. In just two years, this "other revenue" line has grown from 23% to 34% in relative importance to all revenues, and for LIBs, it now totals over 57% of their total revenues!

Unbroken by the crash, this line's continued growth, both in aggregate and relative to other revenue sources, reflects the changing nature of Wall Street towards risk-based, principal transaction, investment banking. For some time now, the growing fees earned in the sizable M&A portion of this line have been augmented by profitable cash-outs of firms' equity portions in these deals. But as some of these highly leveraged (and often sizable) transactions now begin to unwind (i.e. Campeau/Allied/FDS), also sizable realized and unrealized losses may begin to eat into, or even reverse, previously booked income. Third quarter results are expected to reflect some of this trend, particularly for the main players, LIBs and some NFLs.

Exhibit 2 puts the industry's three main revenue lines into perspective. The traditional, safe revenue source (and until the mid-Eighties, the single largest), commissions, has remained basically static this decade, starting at $5.6 billion in 1980, peaking at $12.7 billion in 1987, and falling back to $8.8 billion last year and $10 billion this year, annualized. Commissions are becoming less important to the overall industry's income statement -- just 17% of total revenues the past few years. However, for many smaller firms, it is still the dominant revenue source.

EXHIBIT 2



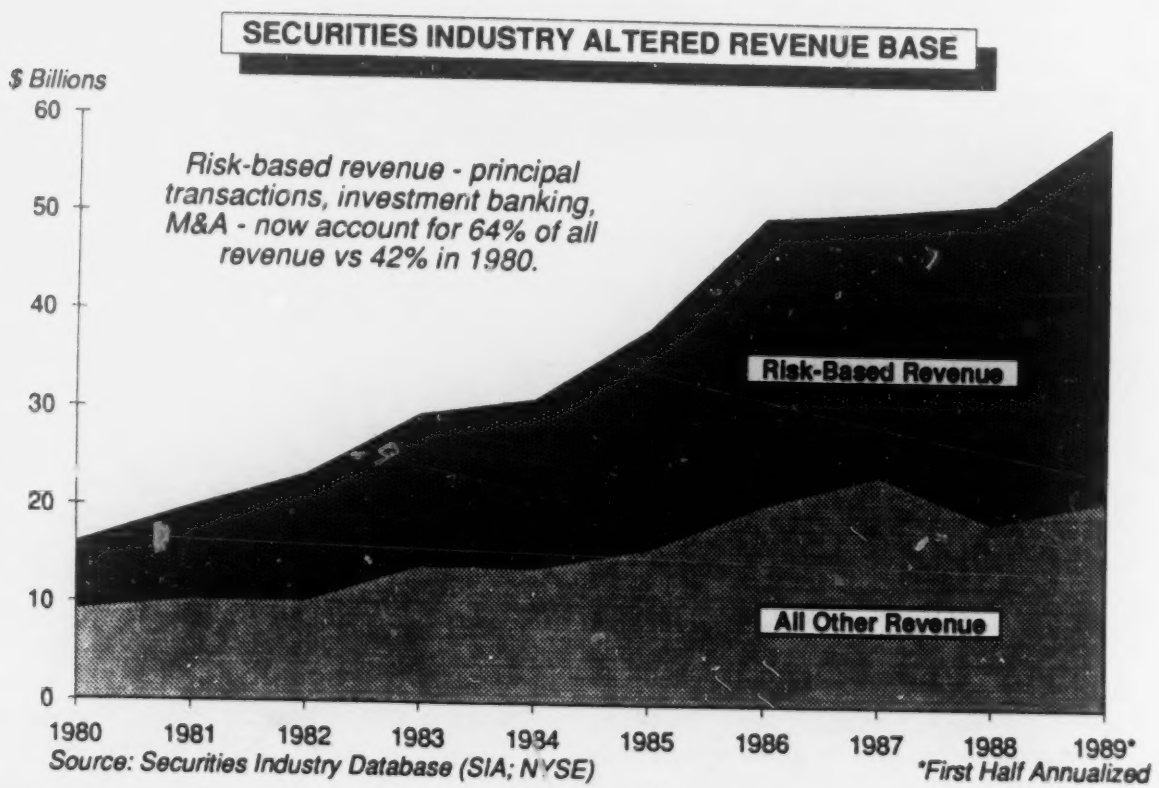
Principal transactions, mainly debt trading, have grown four-fold over the same time frame, from $3.7 billion to a $14 billion pace this year, or about a quarter of all revenues. Even this amount is understated since principal transactions are not reported as gross revenue but as trading and investment gains net of losses.

Again, the biggest revenue line today, accounting for one-third of total revenues, is the "other securities related" line, which at a $20+ billion clip this year is 12 times its' 1980 level. With such a large portion of revenues now being reported in this nebulous line, we thought it important to try to analyze the main segments of this revenue growth.

TODAY'S SECURITIES INDUSTRY: A RISK-BASED BUSINESS

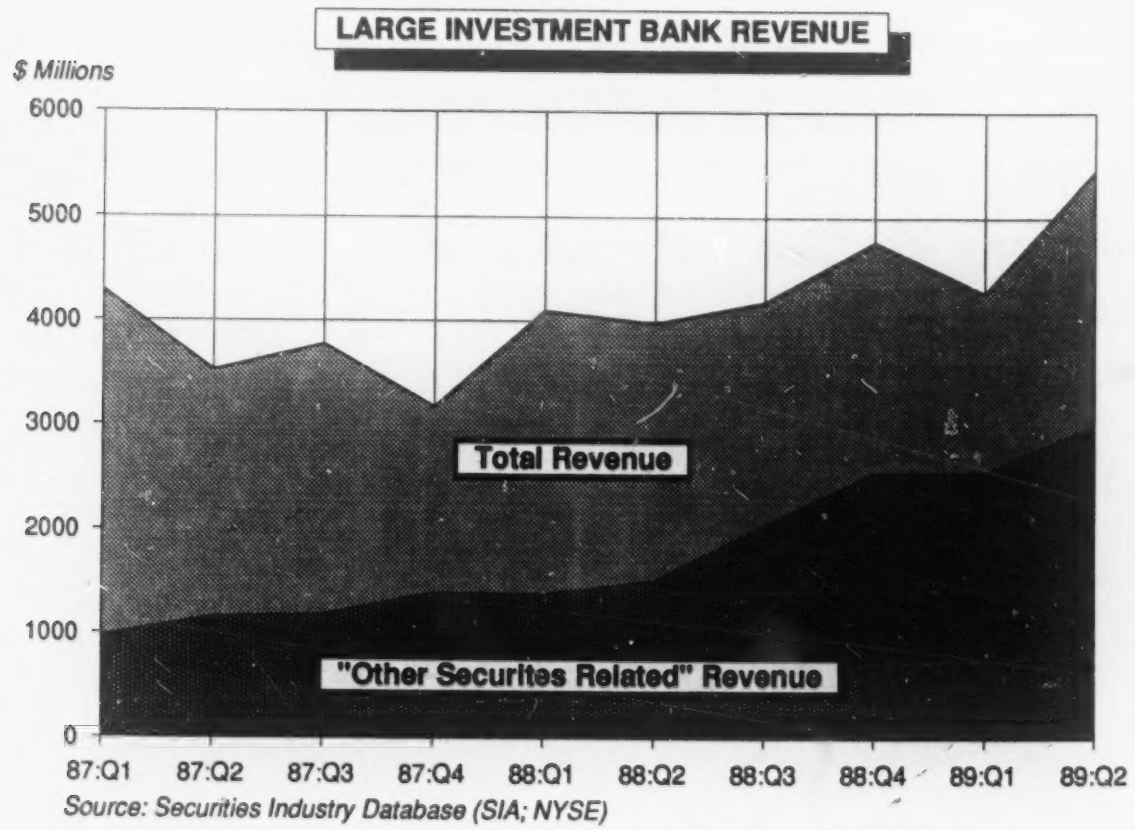
Exhibit 3 shows just how much of the securities industry's revenue base has become "risk-based." Included are trading and investment gains (losses), otherwise called "principal transactions," underwriting revenues and the "securities related" revenue line, again, mainly interest, private placement fees, and M&A and merchant banking revenues. A portion of this revenue may be "riskless," such as fees without equity or bridge commitments, and matched repo/reverse repo books. Nevertheless, about two-thirds of the industry's revenue base is now tied to capital at risk!

EXHIBIT 3



With investment banking driving the "other related revenue" line, the LIBs will have a good share of their revenue from this source. **Exhibit 4** shows how rapidly the "securities related" revenue has grown at the LIBs. This line is expected to generate about 57¢ of every $1 of revenue brought in by the LIBs this year compared to 23¢ for the rest of the industry or just 13¢ at Regional firms.

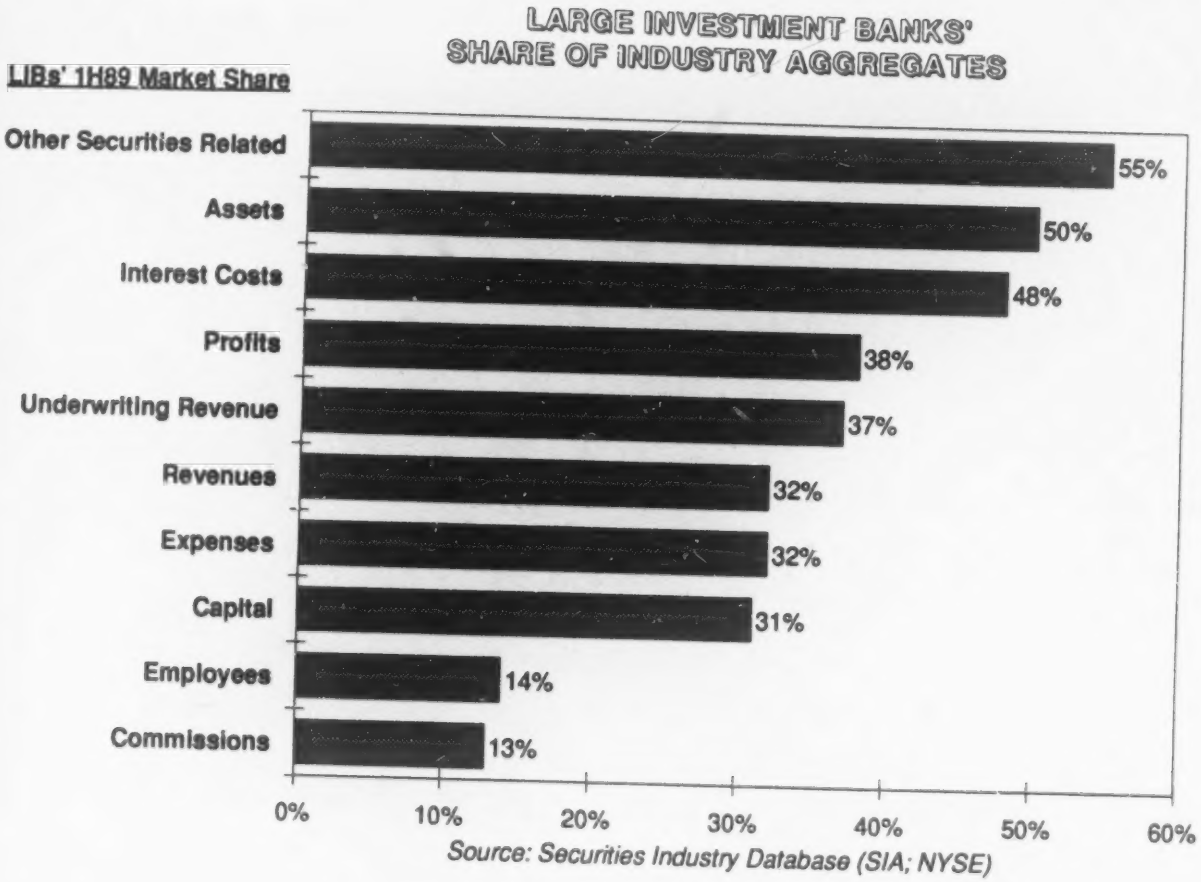
EXHIBIT 4



Source: Securities Industry Database (SIA; NYSE)

The LIBs increasingly dominate this and other revenue lines industry-wide. In fact, these 10 firms account for well over half of the total industry's "other securities related" revenue, the highest of their large market shares in various industry activities. With only 14% of the workforce but 31% of industry capital, these firms' investment banking and risk-related business lines have allowed them to capture not only 55% of "securities related" revenue but 32% of all revenues (and expenses), 37% of all underwriting revenue and, most importantly, 38% of all profits! They also hold half of the industry's assets and absorb half of all interest costs in the industry.

EXHIBIT 5



In other words, LIBs have used capital and leverage to follow their strategic strategy of penetrating risk-based businesses by taking positions in companies and securities to tie business segments together. No longer are they just advisors to Corporate America but the evolution of American finance has required investment bankers to be partners as well, utilizing their capital, a trend that is underway overseas and beginning to be felt in U.S. commercial banking as well.

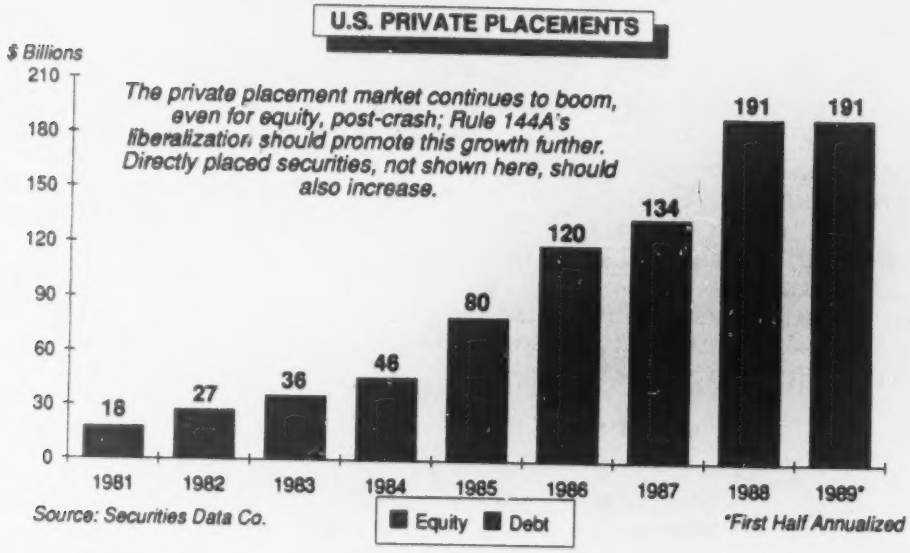
Conversely, the industry's main agency area, commissions, are now only 7% of the LIBs' revenue stream compared to still one-third for Regionals and about one-half for Discounters.

Much of the risk-based and fee-based business is falls into the "other revenue related" line. Private placement fees are one of the main sectors being reported here -- just how much we will now attempt to determine.

PRIVATE PLACEMENTS

Exhibit 6 shows the institutional market for privately placed securities has experienced unbroken growth; even for equity in the post-crash environment. This is a market dominated by LIBs and some NFL firms, as well as money center banks. With the SEC expected to vastly liberalize this market through regulatory changes (proposed Rule 144A - secondary trading of private placements) sometime by year-end, this growth should expand even further, particularly for foreign issuers; but with some degree of domestic new issue flow transferred from registered underwritten securities to the private placement market.

EXHIBIT 6



Surprisingly, the U.S. private placement market is one of the world's largest securities markets. In its' Rule 144A release, the SEC states that the value of bonds outstanding in this market ranks fifth among the bond markets of the world and that the value of U.S. privately placed bonds outstanding equals total Eurobonds outstanding. Despite some private placements of equity (averaging around 8% of total placements the past few years), this is still dominantly a debt market.

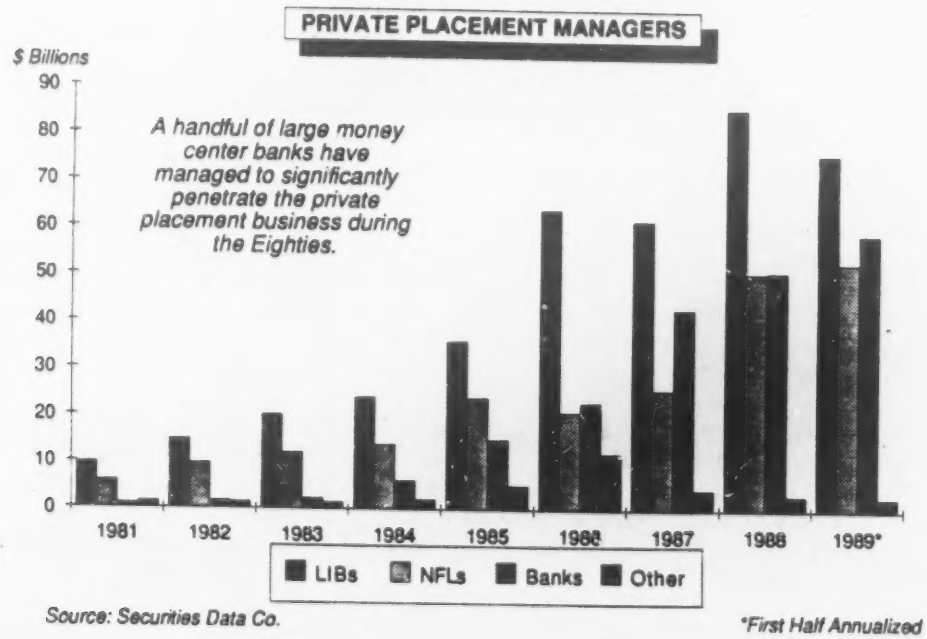
About 40-45% of placements are plain vanilla bonds, 10% are lease related debt financings, and 11% are M&A or acquisition related debt financing. Also, securitized bonds, mainly repackaged receivables, grew to 21% of all placements in 1987 but fell to just 11% last year. Meanwhile, privately placed CDs and deposit notes jumped from 10% of all placements in 1987 to 17% last year.

Banks, mainly money center commercial banks, have made sharp inroads as private placement managers this decade, and not just in CD/deposit notes but also, and in some cases mainly, in areas traditionally handled by investment banks. For instance, in 1989's first half, three of the top four managers of equity private placements were banks with a combined 30% market share. Since they are still prevented from doing public equity underwritings, these institutions have looked to the private placement markets to capture equity business.

Exhibit 7 shows the overall growth for the three main groups of managers of domestic private placements. Handling just under $1 billion, or 5%, of private placements in 1981, banks skyrocketed to managers of $51 billion last year, or 27% of the total placed (through agents and not sold directly), and will handle $60 billion, or 31%, this year based on first half results annualized.

The LIBs still dominate the area but have fallen from a 54% market share in the early Eighties to 40% this year while the NFLs have fallen from one-third to 28%. And with only 15 firms having more than a 1% market share, other types of securities firms have seen their combined market share fall from a high of 10% in 1986 to a mere 1% this year. Another growing trend, although figures are unavailable, is the direct placement of restricted securities with institutional investors, bypassing investment bankers entirely. Rule 144A's enactment is expected to accelerate this trend also.

EXHIBIT 7



With the SEC's liberalized Rule 144A scheduled to take effect around December, we assume that the bulk of the expected increased business will still flow to these 15 firms. There have been comments that the SEC's proposals will allow only 100 of about 9,000 broker-dealers to participate in the private placement secondary market while allowing about 1,000 banks and S&Ls to meet the new "qualifications." However, only the very largest brokers and banks have a meaningful presence in this market now and this is unlikely to change, albeit with market share changes intra-group still very likely.

Fees in this market are not disclosed, and for that matter not all deals are disclosed or discovered by the tracking agencies. Nevertheless, we estimate that the total fees earned in this area probably amounted to $3 billion in 1988 and will match that again this year based on first half results.3/

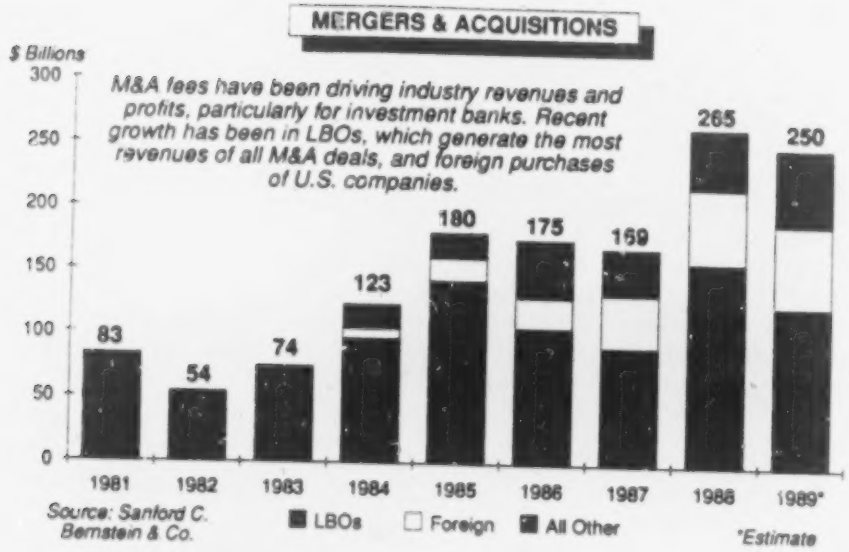
With 40%, or $1.2 billion, of these fees flowing to the LIBs, we estimate that private placements this year will make up about 6% of LIBs' total revenues or about the same amount they receive from commissions. This is also about 11% of their "other related revenue" FOCUS line, leaving the bulk, or $10 billion, still coming from the M&A-related and interest income areas. For NFLs, private placement fees last year (which should be matched this year) amounted to about $840 million -- 4% of their total revenues and 22% of their "other related" revenues. The amounts for all other NYSE firms are negligible.

M&A

The thrust of industry profitability since the crash, although its rise began in 1985, has been M&A related. Exhibit 8 maps out the growth of the the value of completed M&A deals during the Eighties. As is evident, leveraged buy outs (LBOs) have become one of the dominant factors in this area and generate the largest fees, about four times the average M&A fee (per $1 of transaction value) according to Sanford C. Bernstein research, and also generate auxiliary merchant banking fees from bridge loans, mezzanine financings, equity stakes of investment bank participants, etc. and ultimately IPO underwriting fees in some cases.

3/ This is a rough estimate which works out to about 150 basis points of reported volume (with a placement agent). It takes into account the higher, 300-400 b.p. spreads for high-yield and convertible securities, higher spreads for equity (approx. 200 bp's for pfd, 500-700 bp's for common), lower 50-100 bp's for straight debt, and the fact that reported volume is understated.

EXHIBIT 8



Of the top 10 ranked M&A advisors last year, six were LIBs (and two more were in the top 16). We estimate that the LIBs brought in about $2.5 billion in M&A fees last year and may match this again in 1989 (based on first half results). This works out to one-third of their "other related" revenues as a group, although it ranged widely from near zero to near 100% firm to firm.

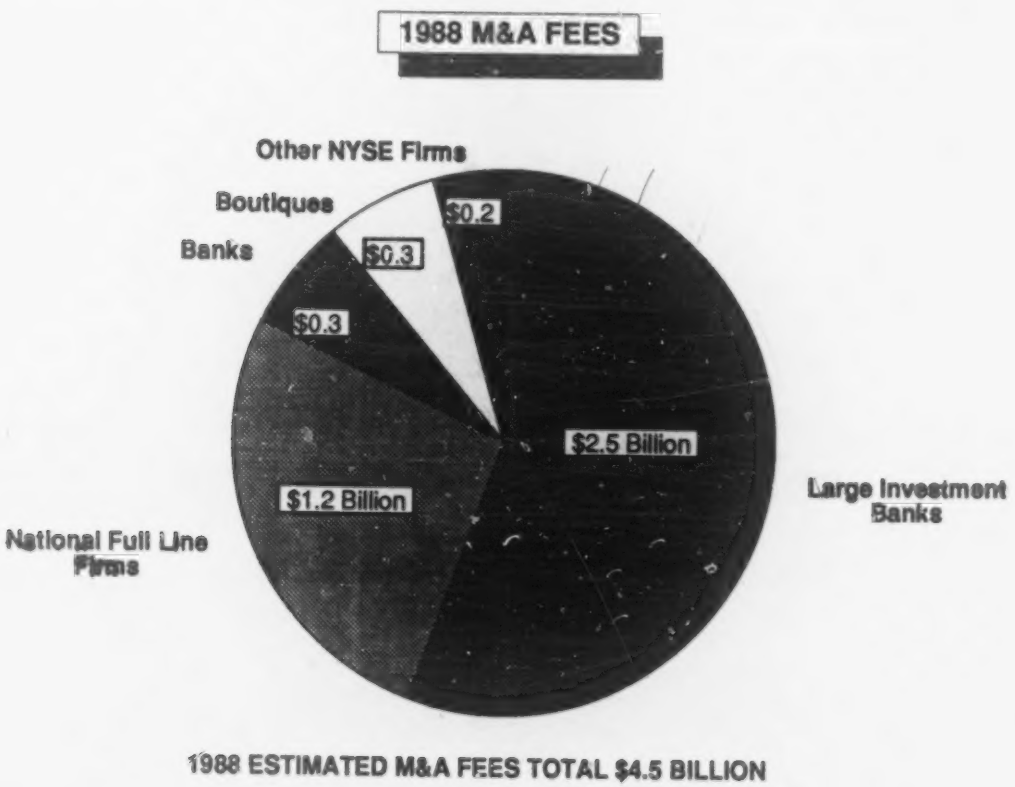
Two NFL firms were among the top five M&A advisors last year, another was in the top 10 and three others made the top-25 tier. We estimate that the NFL broker-dealers earned about $1.2 billion in M&A fees last year (and about the same projected for 1989). This is one-third of the group's "other related" revenues. On an individual basis, it again ranges widely from as little as zero up to a high of 75%.

Besides the LIBs and NFLs, the remaining M&A advisors with 1% or more of the business were mainly M&A boutiques such as KKR, Wasserstein Perella, Blackstone Group, etc., a few banks and other NYSE member firms.

However, of the $5.5 billion in "other related" revenue not attributable to LIBs and NFLs, nearly all is booked by the New York City-based firms, which includes all of the major foreign firms with advisory businesses. These firms are not "the major players" but they certainly outnumber the LIBs and NFLs and relative to their own income statements, the advisory business is important.

We estimate that both banks and the boutiques earned about $300 million each in direct M&A fees last year with about $200 million earned by other NYSE member firms.

EXHIBIT 9



INTEREST INCOME

The only other major remaining "other related" revenue segment is interest income, other than margin interest. Again, the FOCUS reporting form is deficient in determining a major, and growing, securities industry revenue and income base.

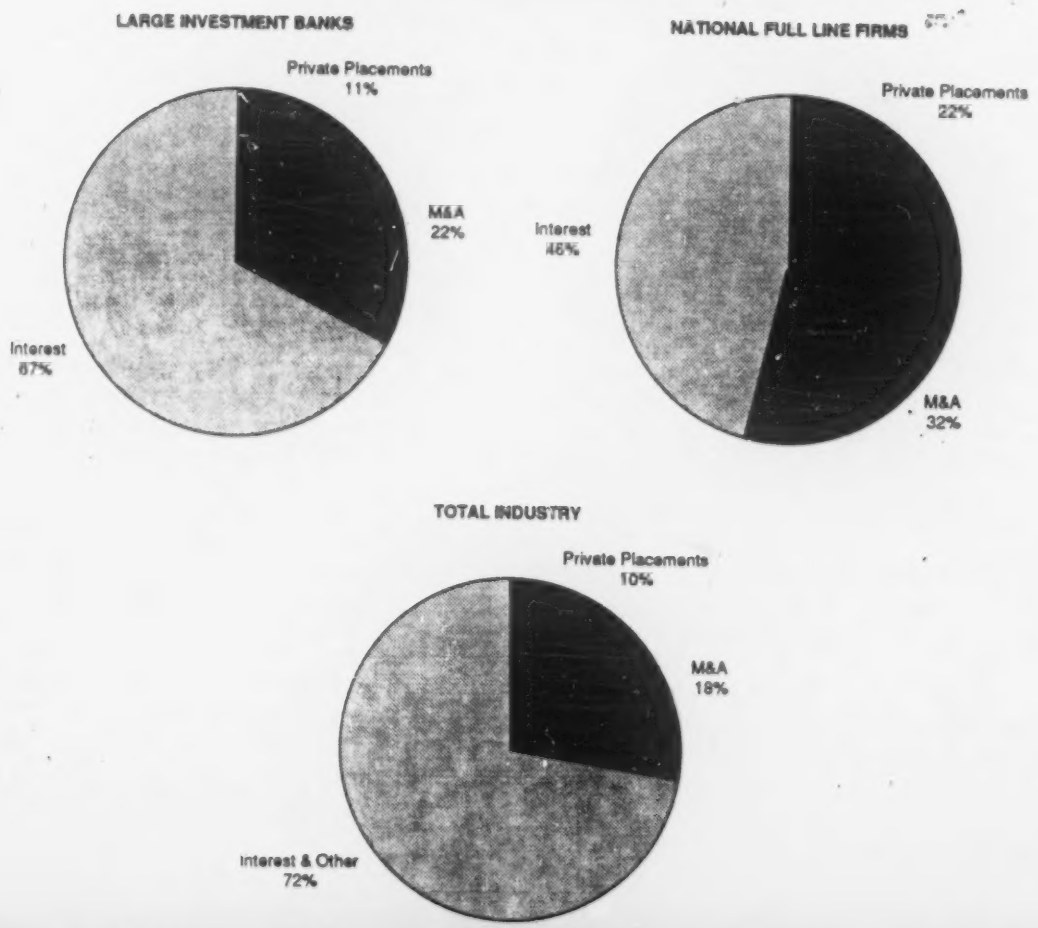
Before attempting to analyze this area, there are a few important points to be made. There is no standard reporting requirement for this area -- even for the publicly-held brokerages. Some firms report grossed-up interest revenue and interest expense while others report net interest income. This is an apples and oranges problem when trying to compare performance measures such as gross profit margin. Profit margins using net interest income will be higher than if gross interest (a larger denominator) is reported as revenues. Also, various sourced interest may be distributed throughout the revenue sheet, i.e. in trading revenues, investment revenues, margin revenues, other related revenues, etc.

Although we know that FOCUS reporting is not uniform, complete or necessarily accurate, the data indicate that for the most part, a good portion of interest revenue is being reported on a gross basis and shown in the "other related" line.

For the LIBs, just three publicly held firms had gross interest revenue approaching $7 billion last year. That alone almost equals the $7.4 billion of "other related" revenues not attributable to M&A and private placement fees. Although these firms have, on average, 30% of their total revenues outside the broker-dealer (FOCUS) unit, their broker-dealer units account for only 45% of the total LIBs and this group (and NFLs) appear to be the most accurate FOCUS reporters. Therefore, we estimate that the vast majority, if not entire, portion of this $7.4 billion in remaining "other related revenue" is interest income (**Exhibit 10**). Also, the growth in this line correlates with growth in related balance sheet items, such as the repo book and other debt inventory.

EXHIBIT 10

OTHER REVENUE RELATED TO THE SECURITIES BUSINESS
"An Attempt at a Breakdown"



Similarly, the publicly held NFLs alone had gross interest revenue totaling nearly $12 billion. Although half of the NFLs' revenues fall outside of the FOCUS reporting broker-dealer, this figure vastly exceeds NFLs' "other related" revenue, even before adjusting for M&A and private placements. Again, we estimate that the balance of $1.8 billion of "other related" revenues must be all interest income.

With no meaningful sample group of non-LIB, non-NFL firms being publicly held, we cannot attempt to determine what level of revenue is from interest sources. Although there are a significant amount of firms reporting all sorts of revenue on this line, we still believe the majority of the remaining balance is interest income.

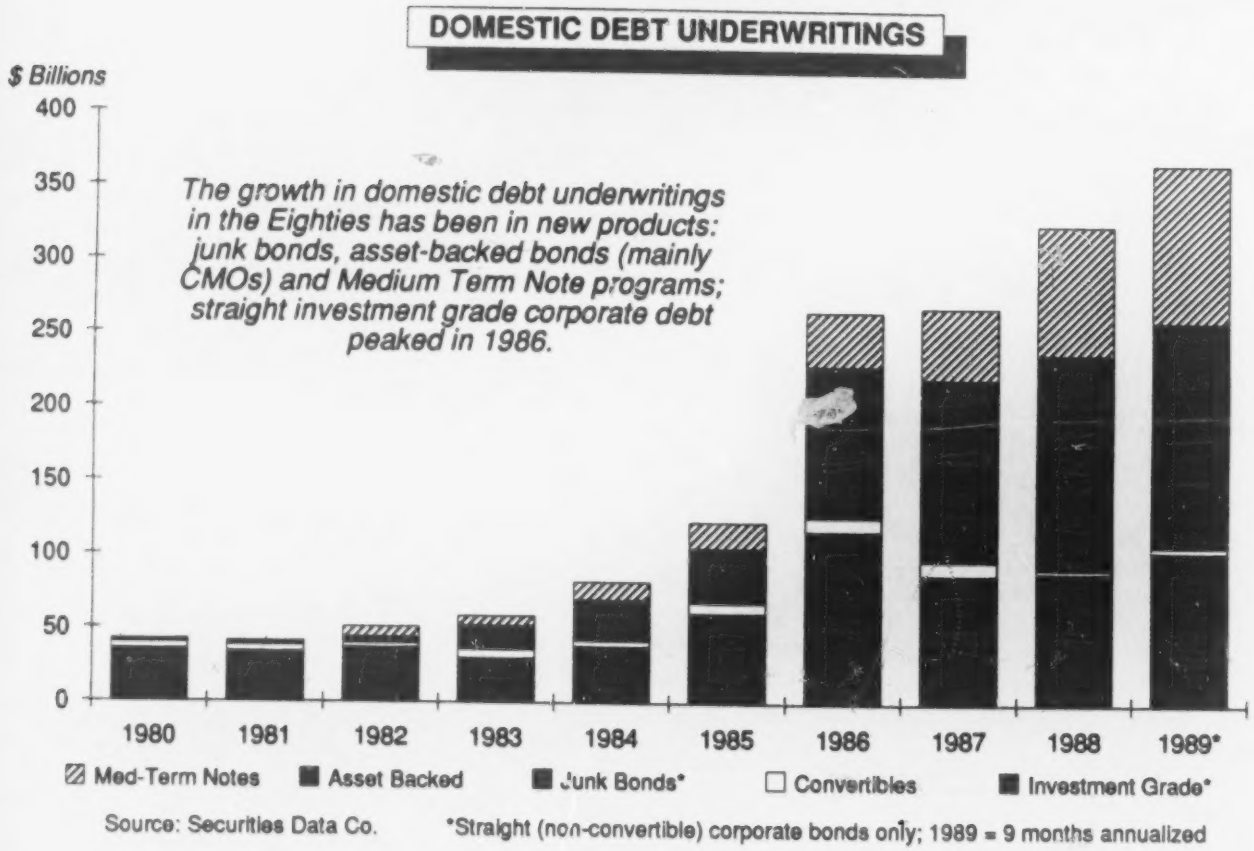
UNDERWRITING

Besides these "other related" revenues which have driven industry profitability, there are other capital markets areas still bringing in steady revenues. A major source comes from the underwriting area, although corporate offerings have been soft since the crash and municipal offerings have nose-dived since TEFRA's enactment (with provisions placing limits on certain tax-exempt financings). This field is also dominated by the LIBs, NFLs and for "allowed" securities, i.e. municipal G.O. Bonds, banks (although their entrance into "non-allowed" securities is now being shepherded by their own regulators).

Municipal underwritings have been marginally profitable at best the past few years (and indeed the industry has witnessed a widespread contraction in this business, even seeing the top ranked municipal underwriter completely exit the business). The corporate side has also experienced a shrinkage in spreads, business concentration and a slowdown in issuance growth, but is still bringing in a steady stream of revenues to those in the field. In aggregate volume, these underwritings have actually continued to grow, however not in traditional areas.

Corporate straight bond new issues have been basically flat during the Eighties with the only growth coming from the "high-yield" sector. Repackaged mortgages and consumer receivables (auto loans, credit card debt, etc.) have been one of the fastest growing underwritten products as seen in Exhibit 11's "asset-backed" growth. Also, medium-term note programs, more of a revolving credit facility offered by underwriters than a traditional bond underwriting, have grown dramatically. Some of these debt products, however, may flow to the private market after Rule 144A is finalized and will still be dominated by investment banks, but at presumably lower fees and with bank competition added to the already stiff competition amongst broker-dealers.

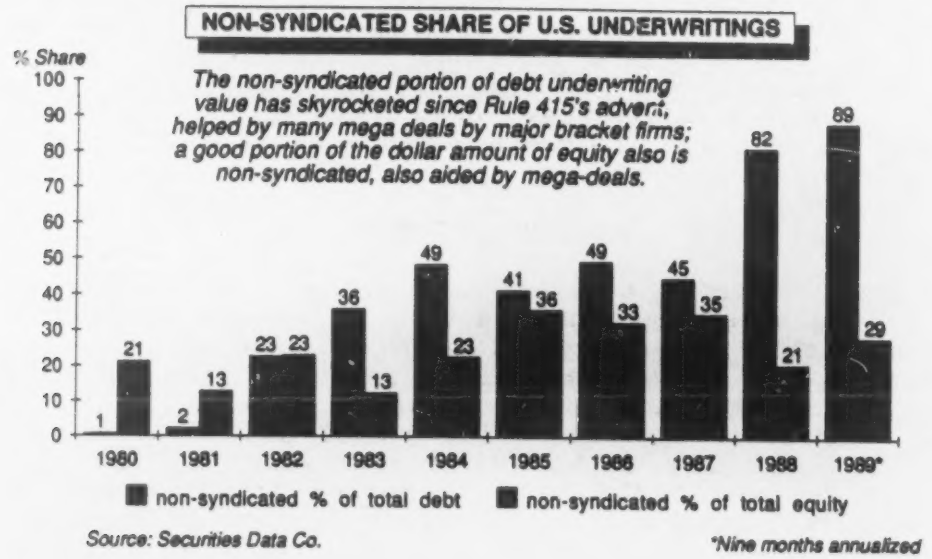
EXHIBIT 11



Another SEC rule which heralded a change in the capital market competitive structure was Rule 415 enacted in 1982. This year, nearly 90% of the value of all bond underwritings will be handled strictly by one or several co-managers with no syndication at all (**Exhibit 12**). That compares to nearly 80% being fully syndicated to a wide range of firms during Rule 415's first year and nearly total syndication prior to its enactment.

The figures reflect more than one trend. Mega-deals have become more frequent and account for a large and growing share of the bond totals. These deals are often sole-managed and thus tilt the overall total towards the non-syndicated side. Also, the business is increasingly concentrated among the New York major bracket firms, the same firms which are not syndicating most of their deals. Still, the ultimate result is that there is far less volume of new issues for non-originating firms to participate in as underwriters or selling group members. And certainly the smaller, syndicated regional deals in no way make up for the lost business. Dramatizing the point, Regional firms accounted for 19% of all underwriting revenues in 1980 -- last year, their share was half this level, or 10%.

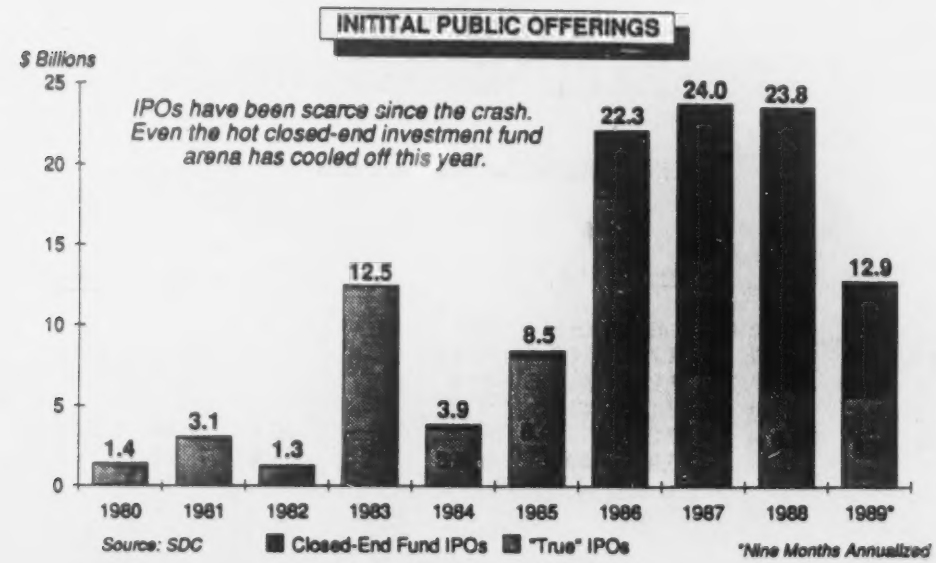
EXHIBIT 12



Equity underwritings have not been fully affected by this trend. However, the larger and often best deals, if not technically non-syndicated, are often cited as having the bulk of their distribution also kept in the hands of the lead manager or a few co-managers.

One traditional area that remained more widely syndicated because of its inherently larger risk is initial public offerings, IPOs. This is also the most profitable underwritten product in terms of underwriting spreads. However, this area is also increasingly being concentrated at a few firms and even if it were not, the crash has practically closed the door to these offerings over the past few years.

EXHIBIT 13



Taken together, underwriting, principal transactions (trading and investments) and the "other related" revenue line, we see 64% of the industry's revenue in these "risk-based" lines. Also, the NFLs and LIBs which make up just 5% of the NYSE broker dealer-community have 72% of this total business. Therefore, industry aggregates today are telling the story of the largest firms only. To see how the rest of the industry is faring, we have to look at each constituency individually.

REGIONAL FIRMS

This year's second quarter was really a godsend for many Regional firms which have been having an extremely tough time since the crash. Pre-tax profits in 2Q were $81 million for the Regionals, an almost seven-fold increase from 1Q and the highest level since the 1Q87. Most of the gain came from increased commission business which jumped $64 million to $437 million, a level 33% higher than one year earlier (2Q88). Again, this is not likely to be repeated in 3Q since volume trailed off after June and was particularly slow in September.

Year-to-date, the Regionals are on track for a 75% improvement in profitability with full-year earnings projected to climb to $189 million from last year's slim $107 million. Still, that is far short of 1987's $271 million tally and way behind the $550 million booked in 1986. **Exhibit 14** shows how tight the margins have become, and not just for Regionals.

EXHIBIT 14

PRE-TAX PROFIT MARGINS

(In Percent)

Firm Category	80	81	82	83	84	85	86	87	88	89*
National Full Line	10.9	6.9	8.8	8.6	(0.9)	5.6	6.9	(0.9)	(0.3)	0.5
Large Investment Banks	17.7	15.4	17.4	16.7	11.4	14.6	13.5	4.7	8.4	4.7
Regionals	14.7	11.2	11.1	12.6	2.6	9.4	11.0	5.5	2.6	3.9
New York City Based	14.8	12.6	14.0	18.3	8.9	12.3	16.1	2.9	7.4	5.4
NYSE Discounters	17.5	12.2	13.6	14.0	0.3	8.9	15.7	8.6	3.1	8.5
Total Industry	**14.1**	**10.8**	**13.1**	**12.9**	**5.2**	**10.7**	**11.0**	**2.2**	**4.8**	**4.1**

PRE-TAX RETURN ON EQUITY

(In Percent)

Firm Category	80	81	82	83	84	85	86	87	88	89*
National Full Line	45.0	24.6	29.8	28.1	(2.6)	17.9	20.3	(2.5)	(0.7)	1.1
Large Investment Banks	55.7	56.7	54.8	43.8	31.1	38.5	34.2	15.5	20.4	11.4
Regionals	N.A	37.2	36.0	40.5	6.8	29.0	32.7	17.2	5.4	9.1
New York City Based	N.A	42.1	43.3	50.7	19.9	31.2	38.3	6.2	15.0	14.9
NYSE Discounters	N.A	52.2	53.9	46.7	0.8	25.6	49.5	22.5	5.0	16.5
Total Industry	**49.2**	**35.9**	**40.5**	**36.6**	**13.3**	**29.4**	**28.6**	**6.1**	**9.9**	**9.2**

** First Half Annualized*

Since 1987, Regionals have averaged a 4% profit margin, well below the 10% margins earned from 1981 to 1986. Similarly, ROE has averaged only 11% from 1987-89 compared to 30% for the rest of the Eighties. This, of course, is not only a problem at the Regionals, as the industry's profit margin is one-third its early 1980 levels and ROE is down to one-quarter its' earlier level!

Taking a look at Regionals' 1H89 performance annualized shows the biggest gain this year is commissions, up 22.3% over 1988 levels. Mutual fund sales are up about 20% but are still less than half their 1986 level. Regionals' "Other related" revenue, the big push for the LIBs and NFLs, is only up 3.8% this year. Still, total revenues are climbing about 15% from 1988's poor showing.

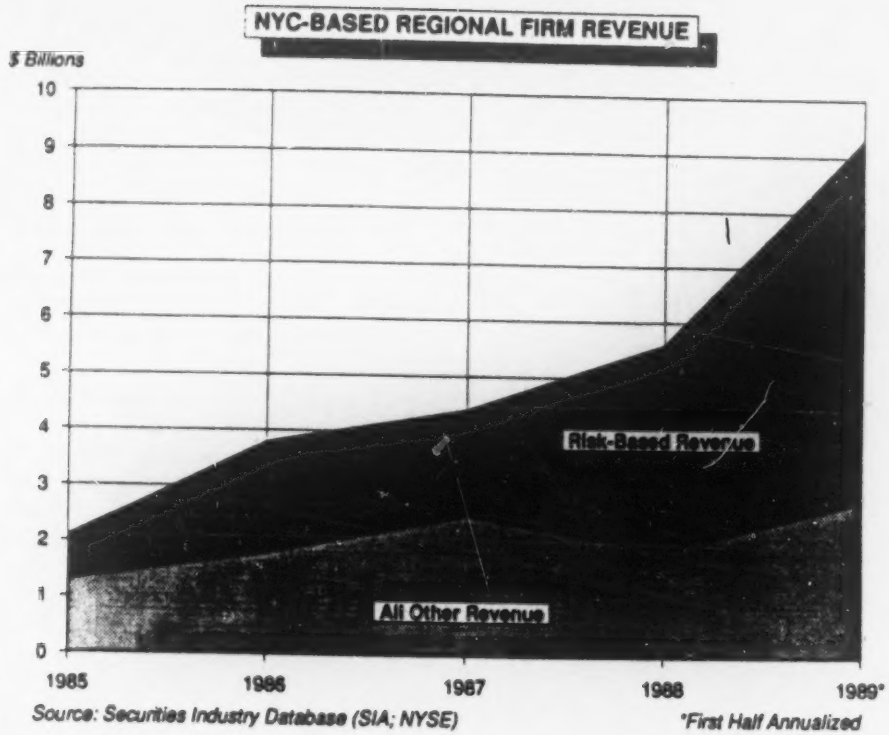
However, expenses are heading up also. Compensation costs are rising 10% this year following last year's 17% slash in this cost. Compensation actually bottomed out in 2Q88 and by 2Q89 have climbed back up to levels almost equal to those being spent just before the crash. However, the uptick is coming from increased broker production since clerical compensation has been checked: falling at a 3% rate this year following a 9% cut last year. Employment levels at the Regionals continued to hit new lows in 2Q; since the crash, the producer and clerical workforce is down 19% and 17%, respectively.

Floor costs are also shooting up over 20%, based on first half results, while interest expense will climb 37% or by $150 million by year's end. The only other expenses in check this year are technology expenditures (communications, EDP) which are holding even to last year's levels, and promotional costs, down 7%. Everything else is up with a resultant 13% projected increase in total expenses for the year.

NYSE DISCOUNTERS

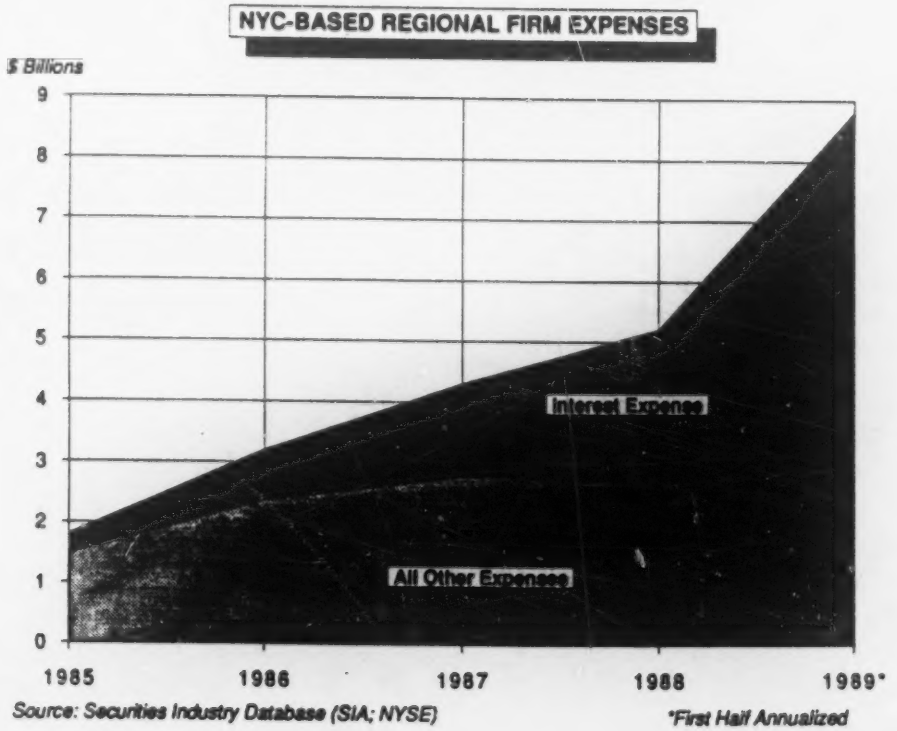
Discounters were <u>initially</u> the least affected by the crash, receiving record commissions in 4Q87 on crash inflated sell volume. The group only lost money in that quarter due to one customer's bad debts at one firm. But with the crash chasing the individual investor out of the market, 1988 was the leanest period for this group since 1984. Pre-tax profits per quarter last year ranged in the meager $7 to $10 million area. This shot up to $24 million in 1Q and $29 million in Q2, for a projected 250% increase in profitability by year's end. However, the key to maintaining this track for discounters is retail commissions, and we expect 3Q's levels in this area to retrench. October's recent events may again temporarily boost commission revenues but the longer-term impact of the volatility on the retail investors' psyche has yet to be gauged.

EXHIBIT 15



Source: Securities Industry Database (SIA; NYSE)

*First Half Annualized



Source: Securities Industry Database (SIA; NYSE)

*First Half Annualized

NYC-BASED REGIONAL FIRMS

NYC-Based Regionals in many ways now mirror the LIBs. Their revenues, particularly "other related" revenue, has continued to mushroom despite the crash. Over 70% of their revenues this year have been from risk-based activities with 42% of total revenues coming from "other related," mainly interest income, and 23% from trading. Conversely, 63% of their expenses in 1989 have been interest costs (**Exhibit 15**).

These increases have come despite the group's shrinkage from 80 firms to 75 firms since the crash. The NYCs' employment levels are also up, despite the industry's net job loss of 33,000 positions. Producers are up 14% from their pre-crash levels while clerical staff is up 2%.

The group, however, includes all of the foreign firms headquartered in New York, particularly the Japanese, Canadian and European NYSE member firms, which have been trying to expand their U.S. presence.

Further, after seeing their profits plummet from a record $618 million in 1986 to $129 million in 1987 (all due to 4Q losses), the NYCs' pre-tax profits rebounded to $416 million last year and is up another 20% this year, to an annualized projection of $500 million, not too far from their 1986 record.

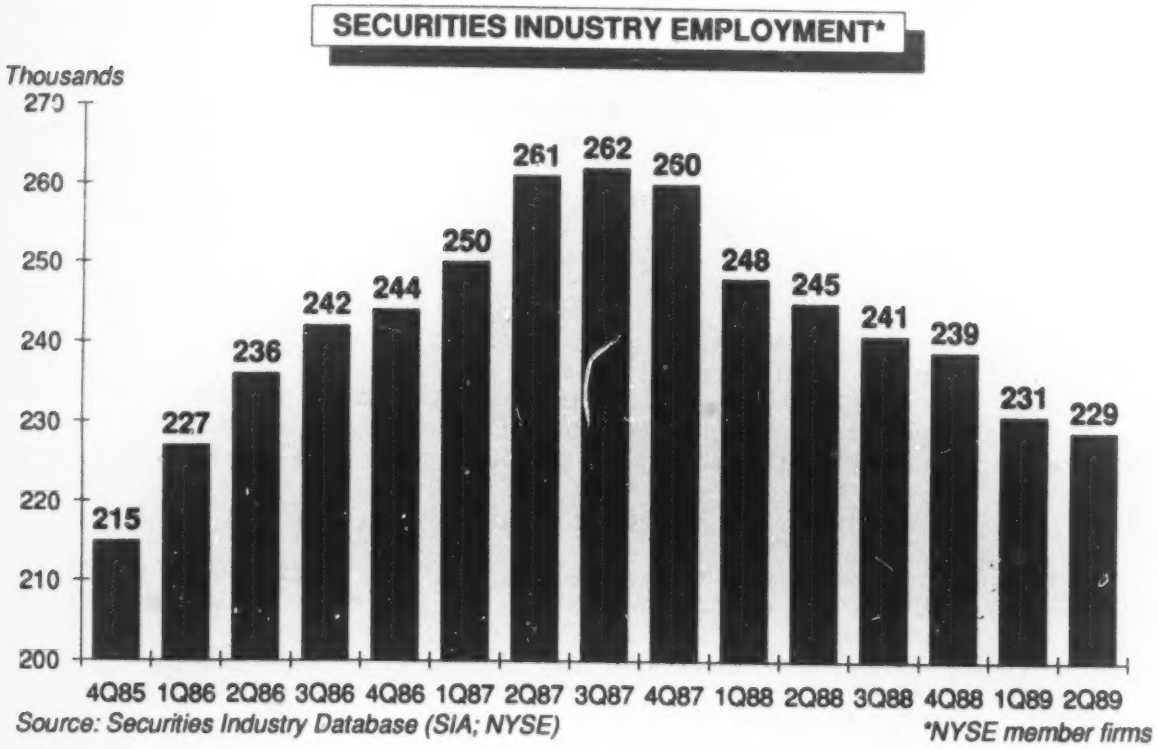
INDUSTRY WRAP-UP

Throughout most of this Trends, we've discussed the major issues affecting the LIBs and NFLs but a few additional points are worth covering. NFLs' compensation levels are again down this year, but only marginally. Total compensation has been gradually reduced from a high of $2.8 billion in 1Q87 to $2.1 billion in 4Q88, but has been creeping up to $2.3 and $2.4 billion in this year's first two quarters, respectively. And this is not solely from increased broker production this year -- both RR and clerical comp are rising again this year despite a continued reduction in both group's employment levels.

In fact, both the clerical and broker workforce at mid-year were back to late 1985, early 1986 levels at the NFLs! The LIBs have also continued the reductions in employment this year. Their producer and non-producer groups at mid-year equaled mid-year 1986 levels and are down about 17% since 1987. Nevertheless, total compensation expense has not been dented and this year's levels will be up slightly to a new record level. Although this is not a healthy sign for cost cutting success, compensation is relatively a much smaller expense item for this group: 22% of total revenues vs. interest expense's 50% share.

Exhibit 16 shows the overall employment trend at the NYSE broker-dealers since late 1985. There has been a 33,000, or 13%, reduction in the workforce in two years; however, this brings the industry only back to 1986 levels which, it must be remembered, were double the employment levels of the industry as the Eighties began.

EXHIBIT 16



Finally, we illustrate the income statement of the "securities industry" in **Exhibit 17**. It compares this year's first half results annualized (doubled) to last year's full-year report. Besides being only the broker-dealer reporting of NYSE members, we have discussed why this statement no longer accurately reflects "the industry." Are industry revenues and expenses up 16% for the typical firm this year? Are profits the past two years each double 1987's level or half the record levels of 1986? Not for most firms.

EXHIBIT 17

NYSE BROKER-DEALER INCOME STATEMENT

(In $ Millions)

REVENUE:	1988	1989*	88 - 89* % Change
Commissions	8,790.5	10,111.0	15.0%
Trading Gains	11,299.1	13,158.6	16.5%
Investment Gains	1,394.2	802.4	-42.4%
Underwriting Revenue	5,158.2	3,839.2	-25.6%
Margin Interest	3,028.5	3,693.0	21.9%
Mutual Fund Sales	1,413.3	1,457.6	3.1%
Fees, Account Supervision	1,884.8	1,945.0	3.2%
Research	23.1	22.4	-3.0%
Commodities	1,382.3	1,525.6	10.4%
Other Securities Related	14,693.1	20,415.8	38.9%
Other Unrelated	2,761.7	3,002.4	8.7%
TOTAL REVENUE	51,828.9	59,972.6	15.7%
EXPENSES:			
Total Compensation	18,739.4	19,197.0	2.4%
RR Compensation	7,580.6	7,460.4	-1.6%
Clerical Compensation	9,280.5	9,561.0	3.0%
Floor Costs	1,756.2	1,902.0	8.3%
Communications	2,548.8	2,437.0	-4.4%
Occupancy & Equipment	3,052.4	3,096.4	1.4%
Promotional Costs	1,003.5	968.6	-3.5%
Interest Expense	16,308.2	23,725.2	45.5%
Errors, Bad Debts	438.1	277.4	-36.7%
EDP	736.6	715.2	-2.9%
Regulatory Fees	371.9	395.6	6.4%
Non-Recurring Charges	56.1	87.0	55.1%
Other	4,325.2	4,729.6	9.3%
TOTAL EXPENSES	49,336.4	57,530.8	16.6%
PRE-TAX NET INCOME	2,492.4	2,441.8	-2.0%

*First Half Annualized

As we've mentioned throughout most of this Trends, investment banking is driving most of the industry's upward results since the crash, that these businesses are concentrated within a few large firms, and even these results are understated since a vast amount of the LIB and NFL businesses are conducted outside their broker-dealer reporting entity.

Nevertheless, we estimate that 3Q results will somewhat temper these annualized projections and with October's uncertain markets, full-year 1989 may have some new surprises in store for us.

George R. Monahan
Director of Industry Studies

VOLUME

	SEPT. 1989	YTD 1989	SEPT. 1988	YTD 1988	% CHG YTD 1989-1988
AVERAGE DAILY SHARE VOLUME ON					
NYSE (MILS.)*	151.8	166.1	145.7	167.3	-0.7%
AMEX (MILS.)*	12.6	12.4	8.4	10.1	22.5%
NASDAQ (MILS.)*	131.3	132.5	111.8	125.1	6.0%
REGIONAL EXCHANGE (MILS.)*	24.5	26.5	21.5	23.1	14.6%
DOLLAR VALUE OF SHARES TRADED ON					
NYSE (MILS.)	$120,174	$1,165,773	$101,435	$1,044,556	11.6%
AMEX (MILS.)	4,504	30,502	2,463	25,321	20.5%
ODD-LOT SHARES PURCHASED ON NYSE (THOUS.)	9,255	88,771	6,759	64,282	38.1%
ODD-LOT SHARES SOLD (INCLUDING SHORT SALES) ON NYSE (THOUS.)	15,336	155,630	14,805	133,588	16.5%
NYSE BLOCK VOLUME AS A PERCENT OF TOTAL SHARES TRADED	49.0%	51.6%	54.7%	55.4%	----
CONTRACTS TRADED (THOUS.)					
CBOE OPTIONS	9,688	97,368	8,841	81,063	20.1%
AMEX OPTIONS	3,740	31,033	2,761	27,466	13.0%
COMMODITY	19,888	206,009	20,185	184,463	11.7%

*MONTHLY AVERAGE
N/A - DATA NOT AVAILABLE

PRICES
(END OF MONTH)

	SEPT 1989	SEPT 1988	% CHG SEPT 1989-1988
DOW JONES INDUSTRIALS	2692.82	2112.91	27.45%
STANDARD & POOR'S 500	349.15	271.91	28.41%
NYSE COMPOSITE	193.97	153.57	26.31%
AMEX MARKET VALUE INDEX	388.76	301.63	28.89%
VALUE LINE COMPOSITE	275.26	234.71	17.28%
NASDAQ COMPOSITE	472.92	387.71	21.98%

YIELDS
(MONTHLY AVERAGES)

	SEPT 1989	SEPT 1988	BASIS POINT CHG 1989-1988
BOND BUYER INDEX (20 BOND)	7.26%	7.66%	(40)
CORPORATE BOND YIELDS (MOODY'S)			
Aaa CORPORATE	9.01	9.82	(81)
Baa CORPORATE	9.91	10.90	(99)
RATIO Aaa CORPS. TO Baa CORPS.	0.91	0.90	1

PRICES
(END OF MONTH)

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Baa CORPORATE	9.91	10.90	(99)
RATIO Aaa CORPS. TO Baa CORPS.	0.91	0.90	1

UNDERWRITING

	SEPT 1989	SEPT 1988	% CHANGE 1989-1988
CORPORATE FINANCING (Gross New Issues - $ Mils)			
TOTAL	$24,211.3	$26,411.0	-8.3%
Common Stock	$2,238.3	$2,367.2	-5.4%
# of Common Stock Issues	43	33	30.3%
Preferred Stock	$719.0	$277.0	159.6%
# of Preferred Stock Issues	4	8	-50.0%
Corporate Debt	$21,254.0	$23,766.8	-10.6%
# of Corporate Debt Issues	102	133	-23.3%

Source: Securities Data Co.

RECENT INTERESTING READING AND STATISTICAL MATERIAL

Item	Description	Source
International Tax Comparisons	Prepared in conjunction with Spicer & Oppenheim, this study provides an overview of the taxation of gains, dividends and interest on portfolio stock investments of individuals in the U.S. and ten other industrialized countries and six Pacific Basin countries.	Securities Industry Association Contact: Carolyn Hildebrandt
Asset Securitization: A Supervisory Perspective	The increase in asset backed securities has led to increasing concern over the supervision of these products. The first section of this article explores mechanics, structure, and incentives for asset-backed securities. A second section outlines issues relating to supervision and sales treatment of asset securitization transactions.	Federal Reserve Bulletin October 1989
Third Quarter 1989 Financing Rankings	For the seventh straight quarter, Merrill Lynch topped the charts as the lead domestic underwriter with $35.3 billion in new issues. The volume of total domestic issues through September 30 was also about the same at $214.9 billion, a slim 3.8% rise. Statistical data ranked by type of underwriting, including mortgage-backed and asset-backed securities.	Investment Dealers' Digest 10/9/89
Europe's Internal Market: What Are They Building	A survey of non-European worries regarding Europe 1992, how much they are justified, what 1992 could do for the world's trading system and how it has altered perceptions of the EEC abroad. Underlying all these attitudes is the question: what is the European Community really building. This survey attempts to help answer this question.	The Economist 8-14/7/89

Item	Description	Source
Bank Intermediation, Bank Runs, and Deposit Insurance	This article examines the reasons why government provides deposit insurance and how the provision of deposit insurance can improve economic performance. While it is argued that the reason for deposit insurance is to promote financial stability by preventing bank runs, the insurance may, however, allow excessive risk taking. This trade-off is examined as well as alternatives to deposit insurance.	FDIC Banking Review Office of Corporate Communications 550 17th Street, N.W. Washington, D.C., 20429 Spring/Summer 1989 Vol.2, No.1
Primary Commodities: Market Developments and Outlook	This study provides an analysis of the market developments in 1988 with respect to primary commodities and the outlook for these commodities in the near and medium term. Attention is focused on the major non-fuel primary commodities traded in international markets.	International Monetary Fund Commodities Division of the Research Department Washington, D.C. 20431 July, 1989
The Japanese Response to U.S.-Canada Free Trade	For the Japanese, the creation of the U.S.-Canada free trade agreement poses both opportunities and threats. This report looks at the Japanese reaction to the FIA through the eyes of Japanese businessmen in Canada and the U.S. Also looks at the U.S-Canada-Japan trading triangle.	The Institute for U.S.-Canada Business Studies Pace University Guy Stanley
Attitudes and Behavior of Affluent Investors	A major new market research study into investor attitudes and behavior. Questions such as "Who do affluent investors consider their primary financial advisor?", or, "What are your client's attitudes toward risk", are answered. The study also includes a transcript of the presentation of the findings to the SIA Sales and Marketing Conference, and interpretation of the data by a panel of industry experts.	Securities Industry Association Cost: SIA members - $75, non-members - $150. Contact: Richard J. Thornblad

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NAVAL SHIPBUILDING

Shipbuilders Council of America • 1110 Vermont Avenue, N.W., Washington, D.C. 20005-3553

December 1, 1988 NAVAL SHIPBUILDING REPORT

Naval Vessels Under Construction

PRIVATE SHIPYARDS NEW CONSTRUCTION

Symbol	Type	No. of Vessels	Total Light Disp. Tons
AGOR	Oceanographic Research Ship	1	2,100
AOE	Fast Combat Support Ship	2	39,400
CG	Guided Missile Cruiser	16	142,560
CVN	Aircraft Carrier (Nuclear)	4	284,000
DDG	Guided Missile Destroyer	3	24,900
FFG	Guided Missile Frigate	1	2,727
LHD	Amphibious Assault Ship	4	114,000
LSD	Dock Landing Ship	6	67,394
MCM	Mine Countermeasures Ship	7	7,000
MHC	Coastal Minehunter Ship	1	780
SSBN	Ballistic Missile Submarine (Nuclear)	8	100,000
SSN	Attack Submarine (Nuclear)	20	120,000
T-AGOS	Ocean Surveillance Ship (Monohull)	7	11,200
T-AGOS	Ocean Surveillance Ship (SWATH)	4	9,944
T-AGS	Oceanographic Survey Ship	2	17,620
T-AO	Fleet Oiler	10	95,000
WMEC	Medium Endurance Cutter (USCG)	3	3,600
	TOTAL	99	1,042,225

PRIVATE SHIPYARDS CONVERSIONS AND MODERNIZATIONS

Symbol	Type	No. of Vessels	Total Light Disp. Tons
AO(J)	Fleet Oiler(Jumbo)	4	46,430
T-ACS	Crane Ship	2	33,200
T-AG	Acoustic Research Ship	1	4,037
	TOTAL	7	83,667

NEW NAVAL VESSEL CONSTRUCTION
December 1, 1988

PRIVATE SHIPYARDS

Shipyard	Navy No.	F.Y. Program	Date	Name	Light Disp. Tons	Actual Launch Date	Est. Delivery
AVONDALE INDUSTRIES	T-AO-194	'86	6/88	JOHN ERICSSON	9,500		9/90
Westwego, Louisisana	T-AO-195	'86	2/86	LEROY GRUMMAN	9,500	KL	5/89
	T-AO-196	'87	6/88	KANAWHA	9,500		6/91
	T-AO-197	'87	2/87	PECOS	9,500	KL	3/90
	T-AO-198	'88	6/88	----------	9,500		10/91
	T-AO-200	'88	10/88	----------	9,500		7/92
	T-AO-202	'89	10/88	----------	9,500		3/93
	T-AO-204	'89	10/88	----------	9,500		12/93
	LSD-44	'84	11/83	GUNSTON HALL	11,100	6/87	1/89
	LSD-45	'85	11/84	COMSTOCK	11,100	1/88	6/89
	LSD-46	'85	11/84	TORTUGA	11,100	KL	11/89
	LSD-47	'86	12/85	RUSHMORE	11,100	KL	4/90
	LSD-48	'86	12/85	ASHLAND	11,100		8/90
	LSD-49(CV)	'88	6/88	----------	11,894		11/93
BATH IRON WORKS, CORP.	CG-58	'84	12/83	PHILIPPINE SEA	8,910	7/87	1/89
Bath, Maine	CG-60	'85	11/84	NORMANDY	8,910	3/88	10/89
	CG-61	'85	11/84	MONTEREY	8,910	KL	3/90
	CG-63	'86	1/86	COWPENS	8,910	KL	7/90
	CG-64	'86	1/86	GETTYSBURG	8,910	KL	11/90
	CG-67	'87	4/87	SHILOH	8,910		12/91
	CG-70	'88	2/88	----------	8,910		12/92
	DDG-51	'85	4/85	ARLEIGH BURKE	8,300		2/91
	DDG-53	'87	9/87	JOHN PAUL JONES	8,300		7/92
BETHLEHEM STEEL CORP.	T-AGS-39	'85	6/85	MAURY	8,810	9/87	12/88
Sparrows Point, Maryland	T-AGS-40	'85	6/85	TANNER	8,810		7/89
GENERAL DYNAMICS CORP.	SSBN-734	'81	1/82	TENNESSEE	12,500	12/86	12/88
ELECTRIC BOAT DIVISION	SSBN-735	'83	11/82	PENNSYLVANIA	12,500	4/88	8/89
Groton, Connecticut	SSBN-736	'84	11/83	WEST VIRGINIA	12,500	KL	4/90
	SSBN-737	'85	8/85	KENTUCKY	12,500	KL	12/90
	SSBN-738	'86	3/86	MARYLAND	12,500	KL	12/91
	SSBN-739	'87	5/87	NEBRASKA	12,500	KL	12/92
	SSBN-740	'88	1/88	----------	12,500		1/94
	SSBN-741	'89	10/88	----------	12,500		10/94
	SSN-752	'83	11/82	PASADENA	6,000	9/87	12/88
	SSN-754	'84	11/83	TOPEKA	6,000	1/88	4/89
	SSN-755	'84	11/83	MIAMI	6,000	KL	10/89
	SSN-757	'85	11/84	ALEXANDRIA	6,000	KL	4/90
	SSN-760	'86	3/86	ANNAPOLIS	6,000	KL	10/90
	SSN-761	'86	3/86	SPRINGFIELD	6,000		3/91
	SSN-762	'86	3/86	COLUMBUS	6,000		7/91
	SSN-763	'86	3/86	SANTA FE	6,000		11/91
	SSN-768	'88	6/88	----------	6,000		4/93
INGALLS	CG-59	'84	12/83	PRINCETON	8,910	10/87	12/88
SHIPBUILDING, INC.	CG-62	'85	11/84	CHANCELLORSVILLE	8,910	7/88	8/89
Pascagoula, Mississippi	CG-65	'86	1/86	CHOSIN	8,910	KL	11/90
	CG-66	'87	4/87	HUE CITY	8,910		6/91
	CG-68	'87	4/87	ANZIO	8,910		12/91
	CG-69	'88	2/88	----------	8,910		9/92
	CG-71	'88	2/88	----------	8,910		3/93
	CG-72	'88	2/88	----------	8,910		6/93
	CG-73	'88	2/88	----------	8,910		1/94
	DDG-52	'87	5/87	JOHN BARRY	8,300		9/91
	LHD-1	'84	2/84	WASP	28,500	8/87	3/89
	LHD-2	'86	9/86	ESSEX	28,500		4/92
	LHD-3	'88	11/87	KEARSARGE	28,500		1/93
	LHD-4	'89	10/88	----------	28,500		4/94
INTERMARINE USA	MHC-51	'86	5/87	OSPREY	780		7/91
Savannah, Georgia							
MARINETTE MARINE CORP.	MCM-2	'83	5/83	DEFENDER	1,000	4/87	7/89
Marinette, Wisconsin	MCM-4	'84	12/83	CHAMPION	1,000	KL	12/89
	MCM-7	'85	8/86	PATRIOT	1,000	KL	7/90

Shipyard	Navy No.	F.Y. Program	Date	Name	Light Disp. Tons	Actual Launch Date	Est. Delivery
McDERMOTT SHIPYARDS Morgan City, Louisiana	T-AGOS-19	'87	10/86	VICTORIOUS	2,486	KL	2/90
	T-AGOS-20	'88	10/88	----------	2,486		1/91
	T-AGOS-21	'88	10/88	----------	2,486		4/91
	T-AGOS-22	'88	10/88	----------	2,486		10/91
NATIONAL STEEL AND SHIPBUILDING COMPANY San Diego, California	AOE-6	'87	1/87	SUPPLY	19,700		4/91
	AOE-7	'89	11/88	----------	19,700		6/92
NEWPORT NEWS SHIPBUILDING Newport News, Virginia	SSN-750	'82	4/82	NEWPORT NEWS	6,000	3/86	1/89
	SSN-753	'84	11/83	ALBANY	6,000	6/87	12/89
	SSN-756	'85	11/84	SCRANTON	6,000	KL	7/90
	SSN-758	'85	11/84	ASHEVILLE	6,000	KL	12/90
	SSN-759	'85	11/84	JEFFERSON CITY	6,000	KL	4/91
	SSN-764	'87	2/87	----------	6,000		11/91
	SSN-765	'87	2/87	----------	6,000		3/92
	SSN-766	'87	2/87	----------	6,000		7/92
	SSN-767	'87	2/87	----------	6,000		11/92
	SSN-769	'88	6/88	----------	6,000		4/93
	SSN-770	'88	6/88	----------	6,000		8/93
	CVN-72	'83	12/82	ABRAHAM LINCOLN	71,000	2/88	10/89
	CVN-73	'83	12/82	GEORGE WASHINGTON	71,000	KL	7/92
	CVN-74	'88	6/88	JOHN C. STENNIS	71,000		12/95
	CVN-75	'88	6/88	----------	71,000		6/98
PENNSYLVANIA SHIPBUILDING COMPANY Chester, Pennsylvania	T-AO-191	'85	5/85	BENJAMIN ISHERWOOD	9,500	1/88	8/89
	T-AO-192	'85	5/85	HENRY ECKFORD	9,500	KL	7/90
PETERSON BUILDERS, INC. Sturgeon Bay, Wisconsin	MCM-3	'84	12/83	SENTRY	1,000	9/86	12/88
	MCM-5	'84	12/83	GUARDIAN	1,000	6/87	6/89
	MCM-6	'85	8/86	DEVASTATOR	1,000	6/88	11/89
	MCM-8	'85	8/86	SCOUT	1,000	KL	9/90
ROBERT E. DERECKTOR OF RHODE ISLAND, INC. Middletown, Rhode Island	WMEC-911	'80	1/81	FORWARD	1,200	8/87	12/88
	WMEC-912	'80	1/81	LEGARE	1,200	8/87	4/89
	WMEC-913	'80	1/81	MOHAWK	1,200	5/88	8/89
TACOMA BOATBUILDING Tacoma, Washington	T-AGOS-11	'87	9/87	AUDACIOUS	1,600	KL	6/89
	T-AGOS-12	'87	9/87	BOLD	1,600	KL	9/89
TODD PACIFIC SHIPYARDS, INC. San Pedro, California	FFG-61	'84	11/84	INGRAHAM	2,727	6/88	6/89
TRINITY INDUSTRIES New Orleans, LA	T-AGOS-14	'85	4/85	WORTHY	1,600	2/88	12/88
	T-AGOS-15	'86	6/86	TITAN	1,600	6/88	3/89
	T-AGOS-16	'87	2/87	CAPABLE	1,600	KL	7/89
	T-AGOS-17	'87	2/87	INTREPID	1,600	KL	11/89
	T-AGOS-18	'87	2/87	RELENTLESS	1,600	KL	3/90
	AGOR-23	'88	6/88	----------	2,100		12/90

NAVAL VESSEL CONVERSIONS AND MODERNIZATIONS
December 1, 1988

AVONDALE INDUSTRIES Westwego, Louisiana	AO(J)-179	'87	7/88	MERRIMACK	11,699		12/90
	AO(J)-180	'88	7/88	WILLAMETTE	11,333		4/91
	AO(J)-178	'89	10/88	MONONGAHELA	11,699		10/91
	AO(J)-177	'89	10/88	CIMARRON	11,699		3/92
TACOMA BOATBUILDING Tacoma, Washington	T-AG-195	'86	2/87	HAYES	4,037		4/90
THE AMERICAN SHIPBUILDING COMPANY TAMPA SHIPYARDS, INC. Tampa, Florida	T-ACS-7	'87	9/87	DIAMOND STATE	16,600		12/88
	T-ACS-8	'87	9/87	EQUALITY STATE	16,600		2/89

EVENTS IN APRIL-NOVEMBER 1988

NEW CONTRACTS

Shipyard	Navy No.	Name	Type	Date
Newport News	SSN-769	----------	Attack Submarine	6/10/88
Newport News	SSN-770	----------	Attack Submarine	6/10/88
Halter	AGOR-23	----------	Oceanographic Research Ship	6/10/88
Avondale	LSD-49(CV)	----------	Dock Landing Ship(CV)	6/17/88
Avondale	T-AO-198	----------	Fleet Oiler	6/20/88
GD, EB	SSN-768	----------	Attack Submarine	6/30/88
Newport News	CVN-74	JOHN C. STENNIS	Aircraft Carrier	6/30/88
Newport News	CVN-75	----------	Aircraft Carrier	6/30/88
Avondale	AO(J)-179	MERRIMACK	Fleet Oiler(Jumbo)	7/15/88
Avondale	AO(J)-180	WILLAMETTE	Fleet Oiler(Jumbo)	7/15/88
Ingalls	LHD-4	----------	Amphibious Assault Ship	10/03/88
Avondale	AO(J)-178	MONONGAHELA	Fleet Oiler(Jumbo)	10/04/88
Avondale	AO(J)-177	CIMARRON	Fleet Oiler(Jumbo)	10/04/88
GD, EB	SSBN-741	----------	Ballistic Missile Sub	10/05/88
Avondale	T-AO-200	----------	Fleet Oiler	10/06/88
Avondale	T-AO-202	----------	Fleet Oiler	10/06/88
Avondale	T-AO-204	----------	Fleet Oiler	10/06/88
McDermott	T-AGOS-20	----------	Ocean Surveillance Ship	10/07/88
McDermott	T-AGOS-21	----------	Ocean Surveillance Ship	10/07/88
McDermott	T-AGOS-22	----------	Ocean Surveillance Ship	10/07/88
NASSCO	AOE-7	----------	Fast Combat Support Ship	11/03/88

VESSELS DELIVERED

NORSHIPCO	T-ACS-6	CORNHUSKER ST.	Crane Ship	4/12/88
Ingalls	CG-57	LAKE CHAMPLAIN	Guided Missile Cruiser	6/01/88
R.E. Derecktor	WMEC-910	THETIS	Medium Endurance Cutter	6/02/88
Newport News	SSN-723	OKLAHOMA CITY	Attack Submarine	6/28/88
GD, EB	SSN-751	SAN JUAN	Attack Submarine	6/30/88
Halter	T-AGOS-13	ADVENTUROUS	Ocean Surveillance Ship	8/19/88
Avondale	T-AO-193	WALTER S. DIEHL	Fleet Oiler	9/02/88
Ingalls	BB-64	WISCONSIN	Battleship	10/20/88

DELIVERIES BY U.S. PRIVATE SHIPYARDS*

	Actual					Future				
	1984	1985	1986	1987	1988	1988	1989	1990	1991	1992	1993
January	1	2(1)	0	1	1		3	0	1	0	1
February	3	3	3	2	1(1)		1(1)	1	1	0	0
March	1	1(1)	4(1)	0	0		2	3	1	2(1)	2
April	3(1)	1	2	3	1(1)		2	4(1)	4(1)	1	2
May	2	4(1)	3(1)	0	0		1	0	0	0	0
June	6(3)	5	0	3	4		4	0	2	1	1
July	4(1)	1	2	1	0		3	4	2	4	0
August	0	3(1)	1	4(1)	1		4	1	0	0	1
September	4(3)	4(2)	1	1	1		1	2	1	1	0
October	1(1)	2(2)	5(1)	2(1)	1(1)		3	1	3(1)	0	0
November	5	7(1)	0	1		0	3	2	2	1	1
December	1	2	3(1)	1(1)	__	8(1)	2	4(1)	3	2	1
	31	35	24	19	10	8	29	22	20	12	9

* Six vessels are to be delivered after 1993

( ) Indicates number of conversions or modernizations in total for that year